RFF Proceedings

# U.S.-Canadian Agricultural Trade Challenges

## *Developing Common Approaches*

**Kristen Allen**
**Katie Macmillan**
***Editors***

**Proceedings of a Symposium**
**Cosponsored by:**

National Center
for Food and
Agricultural Policy
at
Resources
for the Future

C.D. Howe Institute

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Proceedings of a Symposium
held at Spring Hill Conference Center
Wayzata, Minnesota
July 22-24, 1987

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and
C.D. Howe Institute

RESOURCES FOR THE FUTURE
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## CONTENTS

**Foreword** vii
George E. Rossmiller and Maureen Farrow

**Preface and Acknowledgments** ix
Kristen Allen and Katie Macmillan

**An Overview of Agricultural Issues in the U.S.-Canadian Free Trade Agreement** 1
Kristen Allen and Murray Smith

**A Briefing by the Canadian Agricultural Negotiator** 9
Michael Gifford

**A Briefing by the U.S. Agricultural Negotiator** 15
Leo V. Mayer

**Institutions, Instruments, and Driving Forces Behind U.S. National Agricultural Policies** 21
James T. Bonnen

**Driving Forces, Instruments, and Institutions in Canadian Agricultural Policies** 41
H. Garth Coffin

**U.S.-Canadian Trade Liberalization: Key Issues** 65
Bob H. Robinson, Mary Anne Normile, Carol A. Goodloe, and Robert M. House

**Canada-U.S. Agricultural Trade: Market Realities and Opportunities** 75
Barry D. Mehr

**A U.S. Perspective on Measuring Trade Effects of Domestic Agricultural Policies in the United States and Canada** 81
David Blandford

**A Canadian Perspective on Measuring Trade Effects of Domestic Agricultural Policies** 101
H. Bruce Huff

**Specific Commodity Perspectives: Animals and Animal Products Panel** 111
Katie Macmillan, Rapporteur

**Specific Commodity Perspectives: Plants and Plant Products Panel** 115
Kristen Allen, Rapporteur

**North American Agriculture in an Interdependent World: Challenges and Opportunities** 119
Charles Mayer

**Formal and Informal Nontariff Barriers to Agricultural Trade Between the United States and Canada** 123
Barry E. Prentice and Elmer L. Menzie

**Resolving Subsidy, Countervail, and Import Disruption Issues in Canadian-U.S. Agricultural Trade** 139
William M. Miner

**Dispute Settlement in Agricultural Trade Matters: The Lessons of the GATT Experience** 145
Robert E. Hudec

**Resolving Agricultural Trade Disputes** 155
Thomas Reese Saylor

**Canadian-U.S. Agricultural Trade: A Proposal for Resolving Disputes** 161
Debra P. Steger

**Linkages Between Bilateral and Multilateral Negotiations in Agriculture** 169
T. K. Warley

**Discussion** 179
Dale Hathaway

**Discussion: Is Bilateralism Possible?** 183
Timothy C. Mackey

**Summing Up: The U.S. Perspective** 189
D. Gale Johnson

**Summing Up: The Canadian Perspective** 193
Andrew Schmitz

**Epilogue** 197
Kenneth R. Farrell

**Agenda** 203

**Attendees** 207

**About the Contributors** 215

# FOREWORD

The prospect of a free trade agreement between the United States and Canada is an exciting and challenging one. Although Prime Minister Mulroney proposed and President Reagan agreed that the agreement should be as comprehensive as possible, some contentious areas were recognized early in the negotiations. Agriculture was one such area. And the stakes were raised in July 1987 when the United States brought its negotiating proposal before the Agricultural Negotiating Group of the General Agreement on Tariffs and Trade (GATT). By stating its goal to eliminate trade-distorting government subsidies to agriculture, worldwide, over a ten-year period, the United States made an agreement on agriculture in the bilateral negotiations both more crucial and more difficult.

Agricultural trade between the two countries is a relatively small proportion of their considerable total trade, but this does not reduce its importance in a bilateral free trade agreement. Both countries have large agricultural sectors, which, by and large, produce and export a similar mix of commodities and are protected and supported by an intricate web of complex agricultural programs. The two countries compete in some cases for the same segment of world markets for agricultural commodities. And for Canada particularly, the United States is both an important market for and supplier of certain agricultural products.

Within both the agricultural sectors sentiments have run strong about the merits and costs of liberalizing trade between the two countries. The National Center for Food and Agricultural Policy at Resources for the Future and the C.D. Howe Institute saw in these concerns the need and the opportunity to bring together the agri-food sectors (businesspeople, producers, policymakers, and analysts) from both countries, in an informal setting, to discuss openly the issues surrounding the inclusion of agriculture in a bilateral free trade agreement.

The resulting symposium identified and debated the difficulties associated with agricultural trade between our two countries and explored common interests in the resolution of global agricultural issues. Obviously, we would like to think that our discussions in Minneapolis played some role in shaping the trade agreement's provisions for agriculture. What is clear is that, in spite of the trade agreement, many of the specific trade and policy irritants debated at the symposium will continue to plague agricultural producers on both sides of the border. Dialogue between agricultural interests in the two countries, such as that which occurred in Minneapolis, is critical if we are to resolve these bilateral issues or achieve any progress on global subsidy reduction.

The contents of this proceedings volume indicates the breadth of coverage of the symposium. We hope it will be used, not just by those who participated in the symposium, but also by others interested in the issues, to continue the analysis, discussion, and debate on the liberalization of agricultural trade, both bilaterally between the United States and Canada and multilaterally in the Uruguay Round of the GATT.

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# PREFACE AND ACKNOWLEDGMENTS

The discussion of trade liberalization, both bilaterally between the United States and Canada and multilaterally in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), has brought forth impassioned oratory on both sides of the argument and also a considerable amount of high-quality, objective analysis. This symposium was conceived to improve the quality of the former by drawing upon the latter, particularly with respect to the U.S.-Canada bilateral trade negotiations.

The symposium was held in July 1987, when the bilateral negotiations were in full swing and detailed issues were under discussion. When the authors agreed to write their papers, the terms of the agreement were unknown. They could not, therefore, analyze specific sections or components of the agreement. Nor, in fact, was this our aim. Rather, we hoped that the papers would raise some of the many issues that would challenge those responsible for drawing up the final language of the agreement. We hoped that both the presentations and the ensuing discussion would help clarify some of the issues and concerns surrounding agriculture in a bilateral free trade agreement between Canada and the United States. To give a feeling for what is involved in trade negotiations we began with an informal presentation by the two agricultural negotiators for the U.S.-Canadian talks. Michael Gifford and Leo Mayer were then gracious enough to take time from their busy schedules to hear some of the presentations and views from the symposium participants.

The formation of a free trade area between the United States and Canada involves more than an agreement to improve economic efficiency in production and marketing, although this certainly is an integral part of it. Historic and cultural differences must be recognized and accounted for in any agreement that potentially threatens to subsume them. We tried to put some of these developmental differences in perspective by beginning the invited papers with two views on the forces that have shaped national agricultural policies, the U.S. view by James Bonnen and the Canadian view by Garth Coffin.

One of the greatest incentives for trying to negotiate a free trade agreement, or for liberalizing trade in general, is that traditional trade theory shows real gains to be realized from trade. Barriers to trade impose welfare costs on the societies that construct them and on those who would sell to them. The paper by Bob Robinson and coauthors shows both the theoretical gains from trade and some of the gains and losses that might be realized in a U.S.-Canada free trade agreement. Barry Mehr's paper serves to underscore the argument that, while the national economies might be better off with free trade, it would be easier to achieve in some agricultural subsectors than others.

The papers by David Blandford and Bruce Huff get into the difficult area of actually measuring the trade effects of various agricultural policies. The concepts of producer and consumer subsidy equivalents, as constructed and used by the Organization for Economic Cooperation and Development in its recently released Agricultural Trade Mandate Study, have been suggested as tools for measuring levels of protection afforded agriculture and, hence, for monitoring reductions in that protection. As both Blandford and Huff point out, this may be more easily said than done.

The two sector panels were designed to air some of the immediate and longer-term concerns of those agricultural groups most likely to be affected by changes in the trading relationship between the United States and Canada. Each panel, one on animals and animal products and one on plants and products, was a forum for representatives from some industries to present their views and to hear those of others, both on the panel and in the audience. This proceedings volume contains the key points made by the speakers and some of the key questions raised.

In his dinner speech, Charles Mayer challenged the symposium participants to work toward world trading conditions that give farmers a level playing field on which to compete. He reminded us all that, while there are many similarities in the agricultural sectors of the United States and Canada, there are also differences, and the differences often present barriers to liberalizing trade and harmonizing agricultural policies.

Barriers to trade come in many forms. Some, such as tariffs and quotas, are obvious; others, such as subsidies on domestically produced commodities, are less so. The paper by Barry Prentice and Elmer Menzie describes, most thoroughly, the formal and informal nontariff barriers that impede trade between the United States and Canada. It is these barriers that most frequently provoke trade disputes between the two countries, and the resolution of these disputes can involve long and acrimonious litigation. Alternative ways for resolving these disputes was the focus of the four papers by William Miner, Robert Hudec, Thomas Saylor, and Debra Steger.

The last formal presentation looked at the linkages between the U.S.-Canada bilateral negotiations and the multilateral negotiations in the GATT. T. K. Warley's formal paper showed the parallels between the two sets of negotiations and also some of the areas in which they diverge. Dale Hathaway, in discussing Warley's paper, gave an interesting political perspective on agricultural trade negotiations. Timothy Mackey, also a discussant in this section, provided an Australian perspective on both the bilateral and the multilateral negotiations.

Summing up is often the most difficult part of a conference. D. Gale Johnson and Andrew Schmitz took on the task to give their views on what had been discussed (which was much) and resolved (which was little) over the two days of the symposium. Kenneth Farrell wrote the epilogue. It provides something of a postscript to the symposium by outlining what are the final terms of the agreement to be submitted to the U.S. Congress and the Canadian Parliament. The epilogue also looks beyond the bilateral negotiations, pointing out that in more extensive liberalization of world agricultural trade the United States and Canada are likely to be members of the same team.

After the symposium ended, those involved in its organization sat in the chaos of the Minneapolis-St.Paul airport following the tornado and torrential rains that hit the area during the symposium, sipped Molson's beer, ate Virginia peanuts, and reflected on the preceding two days. All in all, we agreed, it was a good symposium; those things over which we had control had gone according to plan. Many people deserve recognition and acknowledgment for that. All the speakers and session chairs who gave their time so cheerfully and enthusiastically have our thanks. We would also like to thank particularly Linda Pierce, Ann Ralosky, and Krystyna Maksalon, who worked tirelessly to take care of the logistics for the whole symposium. The steering committee, especially Ken Farrell and Murray Hawkins, who conceived the project originally, but also Murray Smith, Sandy Warley, D. Gale Johnson, Andy Schmitz, Bob Robinson, Kelley White, Ken Clayton, and Fred Sanderson deserve recognition for getting it going in the right direction. Ed Rossmiller and Maureen Farrow, as director of the National Center and president of C.D. Howe, respectively, have our gratitude for their support and encouragement throughout the project. On the proceedings, editors Elaine Koerner, Dorothy Sawicki, and Barry Norris and typists Mary Ann Daly and Cordelia Sharpe did splendid jobs. And, of course, to the seventy-five people who paid to attend the symposium and who bore the inconvenience of the tornado and the resulting difficulties with so much good will and cheerfulness, we express our heartfelt thanks.

The National Center for Food and Agricultural Policy gratefully acknowledges funding from the W. K. Kellogg Foundation, part of which contributed to making both the symposium and the proceedings possible, and a contribution from the Canadian Agricultural Economics and Farm Management Society toward the publication of the proceedings. The C.D. Howe Institute would also like to acknowledge the assistance of the following in providing financial support for the symposium: the Government of Canada (Department of Agriculture and External Affairs and the Trade Negotiations Office); the Governments of Alberta, Saskatchewan, Ontario, and Quebec; Kraft Limited; and Maple Leaf Mills Limited.

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# AN OVERVIEW OF AGRICULTURAL ISSUES IN THE U.S.-CANADIAN FREE TRADE AGREEMENT

## Kristen Allen and Murray Smith

The idea of free trade between the United States and Canada holds considerable appeal for businesspeople, policymakers, and economists on both sides of the border. The two countries have similar basic economic conditions, natural resource bases, and heritages. They also have the world's largest bilateral trading partnership. There are, however, significant barriers to free trade between the two countries. These barriers--tariffs, quantitative and qualitative restrictions, and government programs that give domestic products an edge over imported competition--prompted the bilateral negotiations that began in May 1986. The ultimate goal of the negotiations is the formation of a free trade agreement between the United States and Canada. Both countries have emphasized that the benefits would be maximized if the agreement is comprehensive, covering all trade in goods and services across the forty-ninth parallel. And yet some issues will be difficult to tackle in a bilateral agreement.

Agriculture is a case in point, for several reasons. Both countries support and protect their agricultural sectors through a variety of market intervention and subsidy programs, as is the case in most industrial countries. These programs often create, or require, trade barriers. The United States and Canada will seek to reduce or remove such barriers in the interest of freer bilateral trade. A bilateral agreement would also signal to the Uruguay Round of the multilateral negotiations, where agricultural subsidies have been singled out for particular attention, that the United States and Canada are serious about trade reform. At the same time, there is some reluctance to enter into commitments on agricultural subsidies in a bilateral context because of the obvious difficulty of limiting concessions to one trading partner. Finally, the agricultural sectors in both countries have, in recent years, been buffeted by financial problems that stem, at least in part, from increased global interdependence. This pervasive sectoral stress makes it difficult for any government to agree to actions that may exacerbate that stress in the short term, regardless of the potential long-term benefits. These barriers, while not insurmountable, loom large in relation to agriculture's relatively small share of the total bilateral trade between the United States and Canada.

### THE U.S.-CANADIAN TRADING RELATIONSHIP--ALL COMMODITIES

U.S. estimates show that bilateral merchandise trade was about US$124 billion in 1986, some $13 billion in Canada's favor (U.S. Department of Commerce, 1988). Manufactured goods and natural resources dominate trade between the two nations. The principal exports from the United States to Canada are vehicles and parts, and communications/electronic equipment. Canada's main exports to the United States are vehicles, vehicle parts, energy (including natural gas, oil, electricity, and uranium), minerals, and pulp and paper products.

Both countries are large exporters, but for Canada the export market is crucial. In 1986, Canadian goods and services exports accounted for just over 25 percent of the gross domestic product (International Monetary Fund). About three million jobs, roughly 25 percent of the Canadian workforce, were export-related in 1985 (d'Aquino, 1985). In the United States, by contrast, exports contribute only 5 percent to the gross national product (International Monetary Fund). In the bilateral trading relationship, Canada relies on the United States as a supplier and as a market much more than vice versa. About 70 percent of Canadian merchandise imports come from the United States; this figure has remained fairly stable over the past twenty years. On the other hand, the United States has been taking an increasing share of Canada's merchandise exports, accounting for about 76 percent in 1984, up from 56 percent in 1960 (Morici, 1987). In 1986, imports from Canada represented about 19 percent of total U.S. imports and Canada bought roughly 25 percent of U.S. exports (U.S. Department of Commerce, 1988). This relatively lopsided trading relationship has caused Canada to view with concern the rising protectionist sentiment in the United States.

## THE U.S.-CANADIAN TRADING RELATIONSHIP--AGRICULTURAL COMMODITIES

In 1986, the two countries traded US$4.5 billion worth of agricultural products, which was just under 4 percent of their total trade that year. The main agricultural exports from the United States to Canada are fruits, nuts, vegetables, animals and animal products, feeds, oilseeds, and oilseed products. The agricultural products that the United States imports from Canada are mainly livestock products, live animals, grains, and grain products. As is the case in total trade, the United States is more important to Canada's agricultural trade than vice versa. According to the Economic Research Service of the U.S. Department of Agriculture (USDA), about 20 percent of Canadian agricultural exports go to the United States; Canadian estimates suggest it may be above 30 percent.[1] Almost 60 percent of agricultural imports come from the United States. Canada supplies just under 10 percent of U.S. agricultural imports and buys a mere 5 percent of U.S. agricultural exports (U.S. Department of Agriculture, 1986).

Canada's agricultural exports to the United States have increased steadily in recent years. Agricultural exports in the other direction were relatively stable between 1980 and 1984, but dropped off noticeably in 1985 and 1986. In 1986 the United States had a farm product trade surplus with Canada of about US$600 million, compared to a surplus of about US$1.5 billion in 1980 (Normile and Goodloe, 1988).[2] The shift has occurred as the U.S. dollar strengthened against the Canadian dollar and is probably due more to macroeconomic events than to events within the agricultural sector.

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[1] Personal communication, Agricultural Counsellor, Canadian Embassy.

[2] Reconciling U.S. and Canadian trade data has been under discussion in recent months. Normile and Goodloe used import data from each country to obtain estimates of exports from the other; i.e., U.S. agricultural exports are taken to be what Canada reports as imports from the United States. The data may, therefore, differ from those in other reports that rely on one country's import and export statistics.

### Agricultural Trade Barriers

The agricultural products traded between the United States and Canada are subject to relatively few quantitative barriers, that is, tariffs and quotas. Both countries raise some tariffs during the production season, mainly for fruits and vegetables, and tariffs are generally higher for processed products. Most tariffs on raw commodities are below 10 percent of the unit value, except for fruit and vegetables, where they average between 10 and 15 percent of the unit value.

Both the United States and Canada use quotas to limit imports of some products. Beef imports, for example, are subject to counter-cyclical quotas in both countries. The United States, in addition, uses quotas on sugar, cotton, and dairy products to protect the domestic support programs. In conjunction with its domestic supply management programs, Canada uses quotas for poultry and eggs, and licenses, permits, and quotas for milk and other dairy products.

There are other barriers to agricultural trade that are raised on both sides of the border that may be stumbling blocks to including agriculture in the negotiation of a comprehensive free trade agreement. These barriers include differences in the systems of government in the two countries, different approaches to supporting agriculture, and nontariff border measures such as phytosanitary regulations. Other papers in this volume discuss these nonquantitative trade barriers and their implications for the U.S.-Canada trade agreement negotiations.

## BROADER ISSUES IN THE BILATERAL NEGOTIATIONS

Both countries have stressed that they seek to achieve a comprehensive bilateral agreement. Despite the aforementioned difficulties surrounding the inclusion of agriculture in such an agreement, it remains part of the negotiating package. In announcing the trade initiative with the United States to the House of Commons on September 26, 1985, Prime Minister Mulroney indicated Canada's intention to seek reductions in a broad range of bilateral tariff and nontariff barriers, to the mutual benefit of the two countries. The U.S. administration, for its part, stressed that its objective was to negotiate a free trade area (figure 1). Both sides agreed that all issues should be on the table, that the terms of the agreement should be phased in by the year 2000, and that the agreement should be consistent with the rules of the General Agreement on Tariffs and Trade (GATT).

The inclusion of agricultural trade when creating a free trade area or customs union has often been a controversial issue.[3] The rules governing formation of a free trade area under Article XXIV of the GATT presume the elimination of all tariffs, including those on agricultural commodities, between the partner countries. But the GATT rules do permit the retention of quotas on agricultural trade within the free trade area for agricultural commodities subject to supply management programs. Not all of the agricultural trade barriers between Canada and the United States fall neatly into these two categories.

The U.S. Congress's approval under the 1974 Trade Act's "fast track" was required to expedite the passage of the negotiated agreement through the Congress. Fast-track

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[3] Working parties were formed within the GATT at the time that the European Common Market and the European Free Trade Association were formed. Objections were registered about the restrictive agricultural trade provisions in those agreements, but no changes in these agricultural trade policies were required.

The following expressions describe degrees of economic integration, moving from basic, informal trading arrangements to full integration of economic systems.

**Preferential trade arrangements** provide lower barriers on trade among participating nations than on trade with nonparticipating nations.

A **free trade area** has no trade barriers among the members, but each nation retains its own barriers to trade with nonmembers.

A **customs union** expands upon a free trade area by setting common trade policies among members towards the rest of the world.

A **common market** builds on a customs union by adding the free movement of labor and capital among members.

In an **economic union**, the fiscal, monetary, and tax policies of the members are harmonized or unified.

FIGURE 1. Degrees of economic integration.

authority imposes certain requirements and deadlines on both the president and the Congress (figure 2).

## Canada's Goals

### *Short-Term, Primary Goals*

In the short term, one of Canada's primary goals is improved and assured access to the U.S. market. Improved access means lower tariff and nontariff barriers. The Canadians are particularly interested in improved access to U.S. procurement markets, for example, selling goods to the federal government and state governments in the United States. Assured access means not being subject to U.S. trade remedy laws (contingent protection). These laws include such actions as imposing countervailing and antidumping duties and granting relief under the Escape Clause (figure 3).

Canada's second short-term, primary goal is improved dispute resolution mechanisms. One suggestion for improving dispute resolution mechanisms is to establish a joint tribunal, with representatives from both countries, that would oversee all U.S.-Canadian trade disputes. Such a tribunal could overcome the problem of different interpretations of trade law by each country.

The U.S.-Canadian free trade negotiations were triggered by Prime Minister Mulroney's announcement to the House of Commons in September 1985. (Amendments to the U.S. Trade and Tariff Act of 1984 require that a foreign country initiate the call for negotiations.) President Reagan then requested approval for "fast-track" authority for the negotiations from the U.S. Congress. Fast-track authority is permission to negotiate an agreement that the Congress will vote either to approve or disapprove, without amendments, within sixty days (or ninety days if it contains revenue provisions) of its submission. The fast-track request was made to the Senate Finance Committee and the House Ways and Means Committee in December of 1985, and the president was required to consult with members of those committees. Each committee had sixty legislative days to consider the request, after which time the authority would be granted automatically if neither committee disapproved the request. The House committee did not hold hearings or vote to disapprove the request. The Senate committee voted in April of 1986, and the result was a tie and thus a failure to disapprove the request. Thus, the negotiations began in Ottawa in May 1986.

Following successful negotiations, the U.S. president is required, under the fast-track approval, to notify the Congress of his intent to enter a trade agreement and to publish such notice in the Federal Register ninety days in advance of entering the agreement. In the case of the current U.S.-Canada free trade negotiations, this deadline was October 3, 1987. During the ninety days, the president must again consult with the appropriate congressional committees, and they may express a negative view of the agreement. If they do not, at the end of ninety days the president may enter into the agreement and submit a copy of the agreement to the Congress with a statement of any actions necessary to implement it. The next step is that a member of each house will submit the implementing legislation to Congress on behalf of the president. The Congress then has a maximum of ninety working days (as tariffs are revenues) to enact the bill and must do so without amending it from the floor.

FIGURE 2. Fast-track authority for negotiations on the Canada-U.S. Free Trade Agreement. *Sources:* Raymond J. Ahearn, "Canada-U.S. Freer Trade Negotiations," Congressional Research Service Issue Brief IB85215 (Washington, D.C., Library of Congress, 1986); Max Baucus, "A Congressional Perception," in Edward R. Fried, Frank Stone, and Philip H. Trezise, eds., *Building a Canadian-American Free Trade Area* (Washington, D.C., The Brookings Institution, 1987).

The United States can take several actions when it determines that its producers and exporters are disadvantaged by production subsidies or trade practices of other countries:

**Countervailing duties** are tariffs imposed on imported products to offset subsidies received by producers in the exporting country. Recent examples include duties imposed by the United States on hogs imported from Canada and by Canada on U.S. corn imports. **Antidumping duties** are tariffs imposed when a commodity is sold in a foreign market at prices below those charged in the home or third markets, or if no other meaningful market exists, below the cost of production. Recent examples include U.S. action against Brazilian orange juice and against flowers from a number of countries including Canada. For both countervailing duties and antidumping, complaints are filed simultaneously with the U.S. Department of Commerce and the U.S. International Trade Commission (ITC). GATT signatories are entitled to an injury test before any action is taken. An injury test is the determination of economic injury to domestic industries due to unfair trade practices.

The **Escape Clause** allows GATT rules to be suspended temporarily to protect domestic producers from injury resulting from increased competition from imports. Unfair trade practices do not need to be proved. The ITC investigates complaints filed by domestic industries, workers, or the president. If injury is found the ITC recommends appropriate actions (e.g., tariffs, import quotas, technical or financial assistance, worker retraining) to the president, who may accept, modify or reject the recommendations. A recent example is the U.S. action on Canadian shakes and shingles.

FIGURE 3. United States trade remedies.

### *Longer-Term, Secondary Goals*

The longer-term gains for the Canadian economy arising from a free trade agreement with the United States can be considered secondary goals. With access to a market approximately ten times the size of their domestic market, many Canadian industries could make longer production runs and realize economies of size. These gains, plus the greater economic discipline imposed due to increased competition from large and often efficient industries in the United States and from less regulation of economic activity, likely will lead to increased productivity for the Canadian economy.

## The United States' Goals

### *Specific Goals*

The potential gains from a bilateral agreement are smaller for the United States than for Canada, and the United States' goals are, consequently, more nebulous. Specific issues of interest to the United States include removing or lowering high Canadian tariffs on products such as processed foods, textiles, and footwear; removing nontariff barriers at both the federal and provincial levels; and removing obstacles to U.S. investment in Canada and export of services.

### *Broader Goals*

The U.S. administration has philosophical and strategic reasons for wanting a free trade agreement with Canada. It would signal to the rest of the world the United States' seriousness in trade liberalization matters. It would also give the two countries a chance to work on some contentious issues that will be on the agenda in the Uruguay Round of multilateral negotiations, including agricultural trade and government support for agriculture.

## CONCLUDING THOUGHTS

Will agriculture be included in whatever bilateral agreement the United States and Canada work out? Certainly there are some formidable problems to be overcome, but to allow these problems to impede progress on a U.S.-Canada trade agreement would set an uneasy precedent for the Uruguay Round of the MTN.

In general, the issues involved in removing transparent border impediments to trade in goods, including agricultural products, are clearly understood. They present few conceptual difficulties for the bilateral negotiations, although there are technical issues that need careful attention. Much work has been completed by the negotiators on these technical issues and they should not be an obstacle to completing the negotiations. The more difficult challenge in the U.S.-Canada negotiations is to strike the appropriate balance between producer and processor interests in commodities subject to quantitative restrictions. Although here, the balancing of competing domestic interests is likely to be the overriding concern, both countries may also wish to ensure that the bilateral agreement sets a precedent for the GATT that they regard as acceptable.

A more contentious set of issues is nontariff barriers to merchandise trade, including subsidies for agriculture; investment matters; and barriers to trade in services. Under the GATT, export subsidies and import quotas have been allowed for agriculture in recognition that many countries support prices and incomes in their agricultural sectors.

In recent years, levels of protection and budgetary outlays for support of agricultural products have escalated in most countries, and some types of support have played havoc with agricultural trade flows. Both the high cost and the distortions in trade flows have created pressure to rein in agriculture. In a May 1987 ministerial communique from the Organization for Economic Cooperation and Development (OECD) in Paris, agriculture was mentioned as a sector where reform is needed to remove various trade-distorting interventions. It was singled out again in June at the Venice economic summit. The treatment of agriculture in the U.S.-Canadian bilateral negotiations may provide a signal as to how agriculture can be dealt with in the GATT negotiations.

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# A BRIEFING BY THE CANADIAN AGRICULTURAL NEGOTIATOR

## Michael Gifford

I guess the problem both Leo Mayer and I have in speaking on this subject is finding something to say that is new and interesting but won't get us both fired. So what I will do is talk mainly about bilateral negotiations, because I think that is probably what most people would like to hear, but to the extent I can I would also like to make some links to the multilateral negotiations.

I'll start with some history. I can think of a dinner I had with a New Zealander in Geneva during the course of the Tokyo Round, about two years into the negotiations that had started in 1975 and didn't really finish until April of 1979. The New Zealander was complaining bitterly that he did not think anything was going to happen to agriculture in the Tokyo Round; he was really down in the dumps. We had spent the best part of two years arguing about process, whether or not agriculture should be treated the same way as industrial tariffs, whether we were going to organize it on a sector-by-sector basis, whether it was going to be done on a request and offer basis, or how we were going to negotiate agriculture. And I, very naively at that point, said well, I thought I could justify my very pleasant existence in Geneva if, by the end of three or four years, I had successfully negotiated the elimination of the U.S. tariff rate quota on potatoes. I could probably go back to Ottawa and say that I had earned my pay.

Several years later, I had dinner with the U.S. negotiator on agriculture--a person most of you know--Jim Starkey, and, yes indeed, by that time we had managed to eliminate the tariff rate quota on potatoes in the United States. But Jim's comment to me after we made that agreement was very revealing. He said, "You know, it is not going to be easy from here on in. You have got the U.S. potato tariff down to 35 cents per hundred pounds, and it's harmonized both ways, but you are going to be having problems because a lot of people in the Northeast will start to make representations and will take advantage of (what later became known as) the trade remedy system."

And of course he was dead right. Since 1978-79, we have had a number of potato cases: an antidump investigation and a countervail investigation against potatoes from the Maritimes going down to the United States; a Section 332 investigation; the state of Maine trying unilaterally to restrict imports of Maritime potatoes into the United States, which resulted in the federal government in Washington obtaining a court injunction to do that; and the U.S. Department of Agriculture, also under pressure from interests in Maine, tightening the inspection system to make it more difficult to export potatoes into the United States. The situation of potatoes indicates to some extent where we're coming from both multilaterally and bilaterally.

As a result of the Tokyo Round of negotiations, what did we accomplish with respect to agricultural trade between Canada and the United States? It was essentially a tariff negotiation, and it was a fairly substantial negotiation. The United States had authority from Congress to reduce tariffs by up to 60 percent and to permit items covered by tariffs of 5 percent or below to go free. By and large, on a request and offer basis, we took the maximum that the United States was able to provide. Because of the fact that the same products are traded both ways on a North/South basis, it has made an awful lot of sense to lower many of these tariffs. We have had almost forty years of experience in the progressive reduction and harmonization of tariffs in Canada-U.S. agricultural trade. We have never attacked nontariff barriers, but we have done a fairly substantial job of reducing tariffs.

Where do we stand now? Roughly 50 percent of agricultural trade is already duty free, and the average tariff on the dutiable remainder is something on the order of 6 percent ad valorem on both sides of the border.

Now this contrasts markedly with the industrial side, where the average industrial tariff in Canada is something on the order of 10 to 11 percent on a dutiable basis, and in the United States it is something like 3 or 4 percent.

As you well know, tariffs are far from the entire story. The reality is that, although we share many similarities and characteristics when it comes to the production side of agriculture in North America, we have evolved quite different support systems and marketing systems.

I would now like to turn to the current round of bilateral negotiations. I will not try to go into the process or encroach on comments that I am sure are going to be made in the rest of the two days here. But I will talk briefly about what it is that Canada is interested in and what it is we hope to achieve in these negotiations. Obviously, the first thing that we or any other agricultural country are interested in is improved access--the classic negotiation of reducing tariffs and easing quantitative restrictions and other nontariff measures.

From a Canadian perspective, just as important as, if not more important than, improving access is securing access. And here what we are looking for are joint rather than unilaterally determined rules as to what constitutes a "fair" playing field or a "level" playing field. Since the Tokyo Round, the emergence of a codified system of trade laws--more codified in the U.S. case--has resulted in a real problem, which can often be described as harassment. At the root of the problem is the propensity of special interest groups on the U.S. side of the border, and more recently on the Canadian side, to use these laws to their specific advantage.

The other thing that we are interested in is getting some discipline on technical regulations and on the importance of technical relations. The reality is that, as tariffs come down, there seems to be an almost proportionate increase in the pressures exerted on the regulators to use sanitary, grading, and labeling regulations as disguised barriers to trade. This is a greater problem in the global context than in the context of Canada-U.S. trade. What both Canada and the United States would like to do in the bilateral negotiations is, in effect, to prohibit the use of technical regulations as disguised barriers to trade and encourage the use of international standards where feasible. Where international standards are not feasible, we would like to ensure that the regulations are administered in such a way that the adverse trade effects are minimized.

Now, how have we undertaken these negotiations? Well, first of all, in contrast to the previous seven rounds of GATT negotiations, we are negotiating them on a comprehensive basis. Let me explain what that means. In the previous rounds, agriculture has always been negotiated on a so-called request-and-offer basis. Now a request-and-offer basis does not work too badly when you have a mutuality of interests and you have similar interests on products that are traded both ways. For that reason what Canada and the United States managed to do in the GATT since 1947 has been quite creditable from the tariff point of view. But using a request and offer approach with the Japanese is useless. You request and they do not offer. You have to develop a negotiating approach, a technique that in fact says that everything is on the table until it is taken off.

Under a comprehensive approach, the deal is there and it can stay as big as you want. It is the exceptions to the deal that are the focus of the negotiations. Of course, there is the risk that if you have too many exceptions, then you unravel the whole thing and you are down to the size of a request and offer. But there is no doubt that a comprehensive negotiation such as Canada and the United States have undertaken offers far greater potential to have a big result. If you get into a request and offer or a sectoral type of negotiation, it is very difficult to develop a large deal.

Both Canada and the United States have agricultural constituencies, and those constituencies have long been convinced that in past trade negotiations agricultural interests were somehow jeopardized to the benefit of the industrial sector. I think I can safely say that for both countries that has not been the case since 1947, and as a practical matter over the postwar period both countries have tried to negotiate agriculture on the basis of achieving a mutually beneficial deal. This has certainly been the experience in terms of the previous rounds of GATT negotiations.

In the Canada-U.S. negotiations, agriculture is the only sector that is really being negotiated on what approximates a sectoral basis. Certain of the agricultural aspects are being negotiated in horizontal groups, but, by and large, the agricultural sector has been identified as a sector for special attention, and of course that reflects to a considerable extent the realities of the two sectors and the extent of government involvement in both sectors. Right at the outset we both agreed that we were not going to try to figure out who subsidized or intervened more. The fact is that the figures speak for themselves. The United States happens to support its grain sector to a greater extent than does Canada, but we support our agricultural sector over a broader range of commodities. So we are faced with some real asymmetrical differences, particularly on a commodity basis.

What are the difficulties in these sorts of negotiations in agriculture? I think I have suggested that you need to address them comprehensively, and you need to address the issues of improved access, security of access, some joint rules on subsidies, and some effective disciplines on technical regulations. If you fail to cover any one of these issues, you will see progress in the others impaired by the lack of discipline on that which was not dealt with.

Technical regulations are in some respects the easiest to deal with. We are not negotiating something brand new; we have got regulators who have gone to the same universities, same graduate schools, on the phone every day to each other, and by and large they want to reduce trade distortions caused by technical regulations and to try to harmonize their systems on international standards where that is feasible. What these negotiations are really doing is simply providing the impetus to shake up what might be charitably characterized as bureaucratic inertia. In other words, we will be speeding up a process that was already well under way. The technical regulations, not surprisingly, are one area where good, solid progress is being made.

It is clear that other areas are much more difficult. I guess right at the outset many observers asked themselves, is there really sufficient critical mass in the bilateral negotiations to enable the two countries to deal with the quantitative instructions at the border? Is there sufficient critical mass to enable Canadian interests to get some disciplines on export subsidies to third markets negotiated in the context of a bilateral agreement?

I think the answers to those rhetorical questions are fairly self-evident. In many areas of continental agricultural trade, the problems are global and the solutions will probably have to be found in the multilateral trade negotiations. But you simply cannot say that we are going to leave everything to the Uruguay Round of negotiations that are currently under way. We are faced with the reality of a large two-way trade flow: agricultural trade is roughly Can$6 billion to $7 billion, and the United States usually has about a Can$1 billion annual trade surplus. It would be desirable to make some progress on these difficult issues in the bilateral negotiations.

The biggest problem in the bilateral negotiations probably relates to commodity-specific subsidies. Both countries intervene extensively. As I said, the U.S. grain subsidies are at a somewhat higher level than the Canadian grain subsidies, but we subsidize more commodities. The United States does not intervene very extensively in the livestock sector apart from the wool deficiency payment, and in Canada there is federal and provincial support for both live cattle and hogs. There is not much support going directly to the U.S. vegetable sector, although producers in Canada feel that indirect subsidies like irrigation systems do affect production decisions in certain parts of the United States. But in Canada some fruits and vegetables have been beneficiaries of direct government support.

Now, given the asymmetrical nature of the subsidy problem and the commodity-specific subsidies that we both have, how do you negotiate some disciplines? On the industrial side, it is easier to prohibit certain subsidy practices because there is less intervention, and when subsidies are provided they generally are not commodity specific. The reverse is true in agriculture: virtually all subsidies are commodity specific. So how do you deal with this asymmetry?

Well, one possibility would be simply to try to do what they are going to try to do in the industrial sector--prohibit certain specified subsidy practices. But is that feasible in a bilateral context when many of these support measures are related to what's happening on a global basis?

Another way of approaching the problem is to say that from the Canadian perspective many of our problems relate to uncertainty. This uncertainty is caused by the perception in Canada that the U.S. system of contingent protection, or trade-remedy legislation, is somehow skewed. If you have an antidump or countervailing complaint, you are well advised to seek immediate U.S. counsel to advise you how to protect your interest under the U.S. litigation system and, depending how complicated the case is, right off you are faced with a $200,000 to $500,000 legal bill from those lawyers in Washington who specialize in this branch of trade remedy legislation.

When Canada applied a countervailing duty on U.S. exports of corn, the first time a U.S. subsidy program has been countervailed, there was a perception that there is something wrong with a system that allows, in effect, private parties to litigate as a means of resolving or removing the adverse trade effects caused by a government practice. One could argue that, because government practices cause international trade problems, the point of reference should be government-to-government consultations to determine whether or not the practice of one country is adversely affecting the interests of the other.

In the bilateral negotiations, Canada has been suggesting, for industrial as well as agricultural trade, that, rather than having a unilateral determination of whether or not a subsidy practice causes adverse consequences for the other party, such a determination should be made by a joint panel or tribunal. And if such a tribunal or panel made a ruling that the subsidy practice of one country was adversely affecting the interest of the other, then the tribunal would quantify the impact and issue a decision instructing the subsidizing country to modify its subsidy program in such a way as to remove the prejudice. And only if the subsidizing country refused to adhere to the panel's decision would the affected country be free to take offsetting action--in other words, to apply a countervailing duty.

Now the third possibility--and all these possibilities are certainly by no means mutually exclusive--is to say, all right, let us agree on certain practices that both countries will deem to be non-trade-distorting. This is the so-called "positive list" or "beacon" approach. Here one can refer to what is going on in the Uruguay Round of negotiations. A couple of weeks ago the United States introduced a very comprehensive and very ambitious proposal on how to negotiate agriculture multilaterally. As you are all aware, one of the aspects of that U.S. proposal was the suggestion that governments should be encouraged to get away from commodity-specific programs and move increasingly towards support measures that are more production neutral and more trade neutral, the best examples being direct income payments.

How are these negotiations going to conclude? Well, I guess I am a confirmed optimist. I think it is possible on the bilateral negotiations to negotiate a credible and mutually beneficial agricultural package that will be deemed to be in the interest of both agricultural sectors. I am also increasingly optimistic about the possible outcome of a new round of multilateral trade negotiations.

It is clear that there are some areas where you can even go further bilaterally than you can multilaterally. Obviously, dispute settlement is an area where we could achieve more between two countries than what either would be prepared to do multilaterally. That being said, it is clear that when it comes to the general question of support of agriculture and reduction of subsidy programs *per se* there's probably greater potential in the multilateral negotiations. Dairy is an example of a commodity area where virtually all industrialized countries have problems, and it is obvious that it is a sector that is going to have to be dealt with on a multilateral basis.

The ambitious nature of the U.S. proposal in Geneva, which suggests the phased elimination of all access barriers and all trade-distorting subsidies by the year 2000, has led some people to ask whether there will be a need for agricultural trade policy offices after that date. Well, even though I hope to be retired by that time, I think there is a future in this very interesting game. That being said, I guess I really am optimistic that by the year 2000 North American agricultural producers will be operating in a trade environment that is less distorted and more responsive to market signals than it presently is, both on a continental basis and multilaterally.

Whether that will come to pass depends on the amount of good will, particularly in the multilateral negotiations. I think that the reality of the last forty years of agricultural negotiations in the GATT are not attributable to the problems of having to negotiate agriculture *per se*. It has simply been the lack of will and the lack of recognition of the real problems of agricultural trade.

Without doubt, in the last twelve to eighteen months there has been a significant change in the way administrators and politicians have been addressing the problem. The recent meeting of the OECD was really a landmark meeting in that there was recognition that in agriculture we have managed to get ourselves into a real mess and the time for change is now. This change will not come overnight. If there is one thing you cannot do, it is change agricultural programs overnight. Some people tend to be cynics. They say that, when you have a bunch of people in the OECD talking, it is noncontractual, it is simply political rhetoric. I think it is important to recognize, however, that even this kind of political rhetoric simply was not possible two or three years ago. There definitely exists an increased recognition that it is time we did something about world agricultural trade.

So to conclude, yes, I am optimistic. I am optimistic on the bilateral prospects, and I am equally optimistic multilaterally.

# A BRIEFING BY THE U.S. AGRICULTURAL NEGOTIATOR

## Leo V. Mayer

Good morning, it's a pleasure to be in Minnesota. I would like to begin by reiterating one point that Mike Gifford made in his presentation. Political will--that is what the success of these trade negotiations is going to depend upon; not only the free trade talks with Canada and any agreement that might develop there, but also the agreement that will be developed in the Uruguay Round of the multilateral trade negotiations (MTN). The question is: how much political will is there around the world really to do something about the mess that farm programs are in on a worldwide scale?

Farm programs are in a mess. Expenditures are just enormous: over US$100 billion between the United States, the European Community (EC), Japan, and other developed countries. What could that money go into that would be more useful than driving up the price of land? There must be something.

How do you build political will? Let me say that I think one way is by meetings such as this, where we get together and we try to decide what is the right direction to go.

The first thing we must do, though, is ask the right question. What's the right question on the U.S.-Canadian free trade agreement? A lot of people have come to me and said, why do we want a free trade agreement with Canada? Some of you may be asking yourself that question. It's the wrong question. The right question is, why not? There may be some good reasons why not, but I think if we identify them, we will find most are going to be for some special interest who doesn't want it. Let's bring them out, identify them, make them justify themselves. The fact that they've been there for forty to fifty years doesn't mean they're justified today. The fact that our farm programs worldwide have been evolving for the last forty to fifty years--100 years in the case of Europe--doesn't mean they're justified today. So it's critical we ask the question, why not? John Stuart Mill told us why we should have free trade: to get the best allocation of resources on a worldwide basis. Well, that's why we ought to do it. Why not is a totally different matter.

So the first thing we've got to do is ask the right question. The second thing you'll hear here today and tomorrow is the following: "the reality is..." I've already heard it once this morning. Well, we all know what reality is, right? We all have our own reality, right? What we really mean is that we know what reality is in our particular little area of the world, our particular industry, our particular business. But there is a much bigger, broader reality out there that we're all having to come to grips with.

We now live in an era where change is the only constant. And that fact is forcing all of us to confront a number of troubling realities:

- The reality of a food and agricultural world where supply and demand runs in cycles: up in the 1970s, down in the 1980s first, and now up again

- The reality of a technical world in which the spread of new technology is shifting comparative advantage within countries, between countries, and between continents, at unbelievable speed

- The reality of a consumer world in which a "search for excellence" has spurred demand for higher quality and a greater variety of products than any country can produce solely within its own borders

- The reality of a government world in which budget crises are forcing almost every nation to reexamine domestic and international priorities

- The reality of a global environment in which the domestic programs of any country can have an impact on every country.

What all this adds up to is that, thanks to modern communications and transportation, all the world's farmers are "next-door neighbors." As a result, farmers here in Minnesota have as much of a stake in policies enacted in Ottawa and Brussels and Tokyo as they do in policies determined in Washington, D.C. The inverse of this is also true: farmers around the world have as much interest in U.S. farm policies as they do in their own.

## COURSES OF ACTION

Faced with these realities, the world's farmers, exporters, and policymakers really have two basic choices:

- They can push for policies that in effect say, "Close the borders, I don't want to compete." That's the gist of legislation that would barricade them behind protectionist trade barriers or provide them outlandish subsidies that encourage self-sufficiency for some item that could be imported at a much lower cost.
- Their other choice is to support production and trade policies that permit the international market to function, that allow innovation by farmers, that offer opportunities for exporters, and that provide security for consumers, through the recognition of the global nature of today's agriculture.

## BACKGROUND FOR CURRENT TALKS

All of this is by way of background to the free trade talks between the United States and Canada. President Reagan and Prime Minister Mulroney have chosen the path of free trade. The trade talks between us reflect their conviction that free trade will produce more jobs, a more productive use of resources, more rapid innovation, and a higher standard of living on both sides of the forty-ninth parallel.

The current talks are the first in nearly forty years in which the United States and Canada have addressed the issue of comprehensive free trade. However, our two countries have been working toward freer trade for more than 100 years.

The first move in this direction came in 1854 when our two countries signed an agreement that permitted each to fish in the other's waters and to trade freely in natural resources. That first treaty lasted for twelve years but was not renewed following British support for the Confederacy in the 1860s.

Another major effort at freer trade between the two nations was made in 1911, when we negotiated a Reciprocity Agreement that would have introduced free trade for agricultural products and reduced tariffs on manufactured products. That agreement was never ratified by Canada because of concerns, stemming from U.S. political rhetoric, that the free trade might have only been a first step in eventual annexation of Canada.

During the mid-1930s, the United States and Canada negotiated a treaty that reduced U.S. tariffs on Canadian goods imposed during the Depression under the Smoot-Hawley tariff rules. The pact was renewed in 1938 but then abandoned in 1948 when both countries participated in the multilateral General Agreement on Tariffs and Trade (GATT).

At the present time, only one major bilateral economic accord--the 1965 treaty creating a duty-free market for automobiles and parts--is in effect between the two countries.

## CHANCES FOR SUCCESS

The current round of talks has been authorized by the U.S. Congress, with the stipulation that they be conducted on a "fast track" basis. However, this authority expires at the end of the year. To meet the deadline, U.S. negotiators need to submit whatever they have come up with to Congress by early October. This means the negotiations are being conducted under great time pressure.

In the negotiations regarding agriculture, we have held meetings at least once a month since July 1986. We have focused much attention on the harmonization of health and sanitary regulations. A task force with representatives from both governments--including veterinarians, plant scientists, meat inspectors, U.S. EPA investigators, and U.S. FDA personnel--was formed to discuss these topics, and I believe we have made some headway on these issues.

We have also undertaken to identify the various agricultural subsidy programs--at the federal as well as the state and province levels--that distort agricultural trade between our two countries.

The subsidy question is one of the more contentious issues that we are addressing. In Canada, the Secretary for External Affairs, Joe Clark, has blamed both EC and U.S. subsidies for "devastating" the livelihood of Canadian farmers. He comments that "agricultural production in Europe is subsidized to an extent that defies all economic sense. The United States finally responded to this structural distortion with equally absurd export subsidies of its own."

While U.S. subsidies are a highly charged issue in Canada, the issue is not entirely one-sided. Last December the government of Canada authorized one billion Canadian dollars for the special Canadian Grains Program to use as a subsidy for the country's grain and oilseed producers. That's certainly a step in the *wrong* direction, as far as our free trade talks are concerned.

As part of the free trade talks, we also have formed a working group on access issues. This group is concentrating on nontariff barriers such as the restrictions imposed by the United States under various import regulation programs and the Canadian provincial wine regulations and marketing boards' import licensing requirements.

The wine and beer access problem exemplifies how a nontariff trade barrier can be every bit as damaging as a tariff. Under Canadian law, complete control over sales and distribution of alcoholic beverages is given to the provinces. Although Canada is currently the largest market for U.S. wines, discriminatory price mark-ups, lack of listing opportunities, and restrictive provincial marketing and distribution practices are serious impediments to expansion of U.S. wine exports.

With respect to beer, U.S. brewers have had little or no success in obtaining provincial liquor board listings allowing them to sell their products in Canada. However, in most provinces beer produced within a given province may be sold in that province outside of the provincial liquor board system. That gives domestic production a large advantage over imported beer. As a result, U.S. brewers have had to license Canadian brewers to produce U.S. brands. And this is at a time when Canadian beer exporters have ready access to a large U.S. market.

Will U.S. and Canadian negotiators be able to draft an agreement where both sides will come out winners--in other words, an agreement that stands a chance of being approved by both the United States and Canada?

One thing that suggests success is that there are strong pressures for a free trade agreement in both countries. While oftentimes the opponents seem to get most of the publicity, there are many, many businesses on both sides of the border for whom freer trade is essential for continued economic growth.

There are also pressures on both of our nations from outside sources--in particular, the European Community, which is becoming more and more protectionist, and the Pacific Rim countries, which are becoming more and more aggressive in exporting. The trade policies of Europe and the Pacific Rim have heightened the importance of the U.S. market for Canada, and the Canadian market for the United States.

## OUR BILATERAL TRADE RELATIONSHIP

The United States and Canada already enjoy the largest bilateral trade relationship in the world.

For U.S. agriculture, Canada is both a major U.S. market and a major supplier to the United States. U.S. agricultural imports from Canada in 1986 totaled nearly US$2.0 billion and Canadian imports from the United States totaled almost US$2.7 billion.

Canada consistently ranks as the fifth or sixth largest U.S. agricultural customer. It is our biggest foreign buyer of a number of high-value products such as oranges and orange juice, fresh grapes, fresh tomatoes, lettuce, and nursery stock and flowers. About 70 percent of U.S. agricultural exports to Canada is comprised of 100-plus products where the export value is relatively small--totaling less than $40 million annually.

Canada also is one of our foremost competitors in third-country agricultural markets, with nearly three-fourths of its agricultural exports destined for countries other than the United States. Besides being our number-one rival in world wheat markets, especially for spring varieties and durum, Canada also is a major competitor in barley, oilseeds, horticultural, and livestock items.

Canada is the United States' largest supplier of competitive agricultural products. Frozen pork, beef and veal, live cattle, and hogs led the list at nearly $1 billion. Other significant Canadian exports to the United States include horticultural items and grain products. Some of Canada's most important exports to the United States are commodities for which it has few alternative markets--for example, live hogs and fresh potatoes.

## A HEAD START ON THE URUGUAY ROUND

While many parties on both sides of the border desire freer trade because it would spur economic growth, it is not solely the value of our mutual trade that makes the U.S.-Canadian talks so significant.

Rather, it is that these talks offer both our countries an opportunity to get a head start on issues that will undoubtedly be addressed in the multilateral forum of the Uruguay Round of the General Agreement on Tariffs and Trade.

GATT is a multilateral agreement that lays down rules governing the trade relations of the member countries.

Since its inception, seven major negotiations to facilitate world trade have taken place under GATT auspices: in Geneva in 1948; in Annecy, France, in 1949; in Torquay, England, in 1951; in Geneva in 1956; in Geneva (the "Dillon Round") in 1960-61; in Geneva (the "Kennedy Round") in 1964-67; and, finally, the "Tokyo Round," which began in 1973 and ended in 1979. You will note that each successive round has taken longer to complete.

The United States has supported the concept of improved trading rules for guiding trade transactions even though, for much of this period, trade was not all that important to the United States. Even today, exports are only 5 percent of our gross national product and represent only 12 percent of the world trade economy, while U.S. GNP is 20 percent of the world economy. Nevertheless, we continue to support further improvements in the GATT as the most logical means of, in John Stuart Mill's words, gaining "a more efficient employment of the productive forces of the world."

## THE URUGUAY ROUND

We are now standing at the beginning of another round of multilateral negotiations. The Uruguay Round, launched last September, is shaping up to be a critical, timely opportunity for us to resolve international trade problems. It is an opportunity we may not have again in the foreseeable future.

U.S. Trade Representative Clayton Yeutter characterized the situation this way:

> One of the major shortcomings of the GATT during its forty-year existence is that it has never effectively confronted agricultural trade policy problems. It has done a reasonably good job in the industrial area over the past four decades, but very little has happened to provide any discipline over the way agricultural trade is conducted.

The United States wants to be sure that in the new round everything is on the table. The fundamental fact for most major commodities is that domestic systems of support and protection inhibit growth in demand, stimulate excess production, and in so doing provoke more frequent use of import restrictions and export subsidies. That simple idea has taken a long time to gain acceptance; but, better late than never.

In keeping with that sentiment, early this month in Geneva, the United States submitted its formal proposal for the reform of agricultural trade under the GATT.

The proposal is simple in concept but sweeping in scope. We are seeking the elimination of all direct and indirect subsidies and all import barriers that affect agricultural trade. We have proposed that these subsidies and restrictions be phased out over the next ten years.

We are not proposing a simple swapping of tariff cuts or other concessions, product by product. We are linking subsidies and access barriers together in order to phase out whole systems of excess support and protection. This is the only way we can end the creation of price-depressing surpluses and put competition back into agricultural markets.

We also are seeking an internationally agreed on approach to assure that the development and application of health and sanitary regulations are based on scientifically verifiable needs and are not used as a means of restricting trade.

Ambassador Yeutter called the proposal a quantum leap forward in the conduct of agricultural trade and a quantum leap forward in the disciplines that will exist throughout the world. He went on to say that everybody will have to go down the road together; trade reform cannot be accomplished unilaterally.

## CONCLUSION

In conclusion, what the United States and Canada are doing in this round of free trade talks is testing the waters for what might be achieved in the multilateral GATT forum. If the United States and Canada--both of which have highly developed agricultural systems, and both of which have a big stake in freer and fairer agricultural trade--can find ways to resolve the issues that trouble our trade, our chance for success in the Uruguay Round will be greatly improved.

I remain optimistic about success in our talks with the Canadians and in our negotiations with our Uruguay Round partners, *provided* we set ourselves the *right* goals.

If our sole object in these talks is to boost exports of U.S. products, we've set ourselves the wrong goal and I suspect both these exercises are doomed to fail.

If, however, our goal is to create a trade environment whereby this country and Canada and all other countries can compete fairly, then I think we have a real chance to succeed.

Success is the outcome that U.S. agriculture, Canadian agriculture, and world agriculture need.

# INSTITUTIONS, INSTRUMENTS, AND DRIVING FORCES BEHIND U.S. NATIONAL AGRICULTURAL POLICIES

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### FUNDAMENTAL FORCES INFLUENCING POLICY

At the most general level at least five fundamental, long-term forces influence policy decisions. These are (1) the reigning values of ideologies of the society, (2) the dominant institutional arrangements, public and private, (3) the level of educational attainment of the society and therefore the ability of the public to understand many of the issues, (4) the impacts of technological change that reallocate property rights and both create opportunities and impose costs on various groups in society, and finally (5) the heavy hand of the past arising out of prior policy decisions.

#### Ideologies

The reigning values of a society tend to be very long-lasting and stamp public policy with a definitive pattern over long periods of time. When values are inconsistent, substantial conflicts and uncertainty in policy can prevail. The United States provides a good example of how conflicting values can give rise to complex and sometimes conflicting policies. Many values were formed in the United States of the eighteenth and nineteenth centuries in a society that in a sense was a small Third World developing nation, trying to survive in competition with many more powerful nations. A weak United States had to fend off stronger European powers while it attempted to settle an entire continental land mass through westward migration. This period lasted until about the end of the nineteenth century.

The nation wanted to be left alone to fulfill its destiny--homesteading and conquering a raw continent. An early and strongly held value running through American political behavior was the belief that it was our manifest destiny to dominate the land mass between the former Atlantic colonies and the Pacific. The Monroe Doctrine was a statement declaring a sphere of influence that excluded the European powers. These beliefs led very logically to another belief that still persists, isolationism. Many early Americans fled from religious and political persecution and conflict and wished to be left alone in religious, political, and economic freedom. Widely held isolationist values delayed American entry into World War I, and led Congress to reject United States membership in the League of Nations following the war. Before the Japanese attacked Pearl Harbor, the same beliefs made it difficult for President Roosevelt to support Great Britain or rearm for World War II. Isolationist beliefs reinforce protectionism and any inclination to pursue a mercantilist foreign economic policy.

Another value firmly ingrained in U.S. behavior is that of rugged individualism, which comes from the early settlement period and expresses a strong belief in individual rights and responsibilities versus those of the community or of collective rights and responsibilities. Closely related is another value arising out of the Anglo-Saxon tradition, which found a very strong expression in the Constitution of the United States. The value of political freedom for the individual was counterpoised against the rights of the state, with the rights of the state substantially restricted by the Bill of Rights and the Constitution. A value conflict that has played a major role in our history is states rights versus federal dominance of the powers of the state. The Civil War established that the United States is a federal system with sovereignty vested in the Nation not the states, although the appropriate balance between the states and the national government continues to be contested.

Laissez-faire versus government control of markets involves conflict between economic values closely related to some of the political values already discussed. In the nineteenth century national political rhetoric celebrated the virtues of the free market, but practice frequently involved government intervention in both domestic and export markets and protectionism when foreign competition made inroads in the United States' markets. Like most developing nations the United States pursued a mercantilist policy. The balance tipped even further toward government control from the Great Depression until deregulation began under the Carter Administration. Only since World War II has the United States provided any leadership for international free trade but, even then, agriculture was excluded from consideration in the GATT--an exception championed by the U.S. until this year, when the Uruguay Round began.

The final value considered is the very persistent one of Jeffersonian agrarianism. In the early days of the Republic, Thomas Jefferson and others argued that the strength of a democratic society was dependent upon a strong, independent yeomanry. Thus it was believed that the numbers and welfare of family farmers were important to the strength of the nation. The facts are that today the farm population constitutes about 2 percent of the national population and farm production less than 2 percent of GNP (Council of Economic Advisors). Nevertheless, the value persists in a populist form that continues to generate popular support for demonstrably obsolete farm programs.

The ideologies to which a nation is committed structure its opportunity set, blocking off many policy options while making others possible or even unavoidable. Ideology shapes human institutions and behavior and, for good and evil, is a major driving force of history.

### Institutions

Policy decisions are also influenced by the nature of the institutions of the society. Institutions differ from one country to another and are defined here to mean the rules of behavior and roles that govern patterns of relationships and actions as well as the public agencies, private organizations, families, and other decision-making units of society. They include the arrangements for public governance, especially the political and policy decision processes of the society. They also include all of the social arrangements and rules that govern production and marketing decisions, including business law. Much of this paper is devoted to describing institutions that affect national policy.

### Human Capital

Another slowly changing major force influencing policy decisions is the breadth and depth of the education levels of the society. The capacity and sophistication of the education system determines the level of economic and political literacy that informs public opinion, an important political influence in any modern democracy. This human capital base allows society to deal more or less effectively with complex problems, whether these be political, social, or technological. We will not explore this dimension.

### Technology

A fourth force in shaping public policy is the capacity of society to modify its technologies and to improve the useful knowledge of society. Behind this base lies some prior investment in institutions and human capital, but technology and knowledge are critical dimensions of the basic capacity of any modern society. Changes in technology and its timing redistribute property rights, create opportunities, and impose costs within and between various societal groups. The effects of technological change will not be dealt with here, except as it has helped create a new United States political actor, the media.

### Past Policy and Political Commitments

Finally, the influence that tends to make policy changes incremental and slow is past policy decisions and the political and ideological commitments of the participants. The dead hand of the past falls heavily on agricultural policy today. Substantial evidence exists that the agricultural policies of most industrial nations are inconsistent with the imperatives of an internationally interdependent world economy. Yet those policies persist and are exceedingly difficult to change.

## EVOLUTION OF UNITED STATES AGRICULTURAL POLICY

In the United States the industrial revolution began about the third decade of the nineteenth century. By the time of the Civil War, industrialization was advancing rapidly. By the beginning decades of the twentieth century, the United States had reached the level of economic and political strength of the European nations with which it competed.

From the early decades of the nineteenth century until the Great Depression of the 1930s legislation addressing agriculture could be characterized as social legislation focused on long-run institutional development. The main purpose of policy for the agricultural sector was the improvement of agricultural productivity and bringing rural living conditions and welfare up to urban levels. A pervasive fear existed that a backward rural sector in an industrial society would be a growing threat to the stability of democratic institutions and could push farmers back into an underclass, if not the peasantry from which many North Americans had escaped. The benefits of these social investments went not so much to individuals as to the whole of the rural sector and indeed to the whole of the society. That is, they provided collective goods. This legislation included the Homestead Act as well as the act establishing the U.S. Department of Agriculture (USDA) and the Morrill Act authorizing the land grant college system, all of 1862; the Hatch Act of 1887 created a national system of state research stations for agriculture; and in 1914 the Smith-Lever Act created a national system of state extension services to disseminate new knowledge and technology to farmers (Bonnen, 1984, pp. 57-58).

With the exception of the Homestead Act, farmers placed little value on the agricultural (institutional development) legislation of the nineteenth century. However, when the farming sector was in economic crisis and disorder and populist violence was perceived to threaten society, the nation responded with another type of legislation regulating the villains that farmers saw as the source of their trouble. From the Civil War to the 1890s, this led to railroad rate regulation and to antitrust legislation attempting to restrain the monopolistic behavior of the nonagricultural sectors with which agriculture dealt.

In the late nineteenth century through the 1920s, and explosively during the Great Depression, Congress began passing narrower, more specific types of agricultural legislation. This included legislation establishing policies and programs in reclamation and water development, rural free delivery of mail, soil conservation, agricultural credit, rural electrification, rural road building, and many other investments in the physical infrastructure and inputs of agriculture. While most of the benefits of these programs were collective goods, many were not available to all citizens or even all farmers, and some laws were administered to create selective benefits for specific groups.

In addition, a new kind of legislation regulating different aspects of agriculture was initiated: for example, fertilizer and seed standards; weights, measures and grade standards; animal health; and food safety. This regulatory legislation imposed direct costs on some, major benefits on other specific groups in society. Most significantly, legislation regulating markets to support the prices of a few politically favored "basic" farm commodities was introduced in 1933 (Bonnen, 1984).

The introduction of very narrow kinds of commodity and other regulatory legislation began the fragmentation of general social policy into legislation creating major impacts on the immediate welfare of specific groups in agriculture. It produced concentrated interests and motivated those affected to organize to influence policy decisions. As a consequence, commodity organizations and other narrow interest groups began to replace general farm organizations as the primary vehicles for political expression of farmer interests (Lowi, 1965). Thus, commodity policy began slowly to dominate agricultural policy debates from the 1930s onward. By the 1950s the creation of highly valued selective goods by these commodity policies had changed the political and economic behavior of the agricultural sector (Bonnen, 1980).

With the passage of the Agricultural Adjustment Acts (AAA) of 1933 and 1938 creating price supports enforced by supply controls (initially in the form of acreage allotments), the United States forfeited its export markets for price supported commodities. In a crisis as deep as the Great Depression and following the very highly protectionist decade of the twenties, this all seemed quite logical. In any case, domestic farm policy dictated that there be no concern for international trade in these commodities. Subsequent policy behavior was reasonably consistent with this closed economy orientation in that there was little or no public investment in market development abroad or in legislation to encourage exports of price supported commodities through the 1940s and 1950s. Among industrial nations, the United States led the way in excluding agriculture from international trade through domestic legislation to protect farm programs from foreign competition. When the GATT was formed in 1947, the United States was instrumental in excluding agriculture from the more stringent provisions for industry. In the early 1950s the U.S. Congress passed legislation that precluded the United States from participating in any trade agreement (including preexisting arrangements) that would change or eliminate Section 22 of the 1935 AAA, which imposed quotas on imports when imports were found to have interfered with domestic price support programs (Sorenson, 1975). The United States subsequently obtained a GATT waiver for Section 22 in 1955.

By the 1960s Congress had begun to enact export development programs for commodities whose prices were supported. It was also in the 1960s that economic development programs abroad began to take on an objective of market development. The resulting inconsistency between the domestic price support system and the effort to expand export markets was recognized in the 1965 Agriculture Act, which changed farm income support to a two-price system for wheat, feed grains, and cotton. Price support guarantees (loan rates) were dropped to world market-clearing levels and higher domestic prices to farmers were maintained by marketing certificates (paid by consumers) in wheat and its equivalent in feed grains and cotton through a deficiency payment from the Treasury (paid by taxpayers). Wheat was eventually shifted to a deficiency payment also. The deficiency payment was provided only on a farmer's share of domestic utilization. It was not paid on the exported portion of farm production (Cochrane and Ryan, 1975).

This lasted until the 1973 farm bill. In part because we had entered a period of tight grain supplies and rapid export market growth, we moved to a new system. From 1973 on producers participating in price support programs were assured a target price *for all of their production* (including exports) though a deficiency payment that was the difference between the target price and the market price (or the price support loan guarantee, whichever was the higher). This target price was set well above world market-clearing prices.

When Congress renewed the price support legislation in 1981, it expected that the export market expansion and rising prices would continue through the next few years. Neither expectation held. Under pressure from commodity interests, Congress specified in the law a schedule of price support loan guarantees that moved up steadily through the life of the legislation. By the early 1980s price support guarantees (loan rates) were above world market-clearing prices for extended periods in some commodities. As a consequence of this and the growing strength of the dollar plus a worldwide recession, the volume of United States wheat exports began to decline after the 1981-82 marketing year (U.S. Department of Agriculture, 1987). Feed grains export volume had begun to decline a year earlier (U.S. Department of Agriculture, 1986). By 1985 the price support guarantees were above world market-clearing prices in most supported commodities. Both government and private stocks were at record levels. The United States was accumulating stocks and in effect supporting world market prices.

It was only with the 1985 Food Security Act that, for the first time since 1973, domestic commodity policy began to move toward greater consistency with international market development. This was achieved by dropping price supports to market-clearing levels and paying a larger deficiency payment to maintain farm income. The 1985 Act changed the deficiency payment calculation to base it on a yield and acreage base that was fixed, thus eliminating some of the incentive to expand production. Dropping price support levels rapidly over the life of the Act results in a very much larger deficiency payment to farmers, since the target price goal was programmed to decline at a much slower rate. This, of course, has a substantial impact on other participants in the international market because a far larger portion of current U.S. production goes into the market rather than into USDA Commodity Credit Corporation (CCC) storage. The Payment in Kind (PIK) feature increases the pressure on world prices by moving current CCC stocks into the market also. Over sustained periods in the past we have maintained domestic farm prices well above market-clearing levels. This created an incentive for expansion of market shares by many countries at little or no cost to those country's taxpayers. The United States withdrawal in 1985 from the policy posture has caused the "chickens to come home to roost" at home (for taxpayers) and abroad (for taxpayers and farmers). The industrial nations are now engaged in a worldwide battle of farm subsidies in which everyone loses except importing country consumers.

## Presumptions Underlying U.S. Agriculture Policy

The values of individualism and independence kept farmers from pressing for (and Congress from awarding farmers) direct aid when they were in trouble in the nineteenth century. This began to change during the farm depression of the 1920s, which followed World War I. By the Great Depression efforts to aid farmers took a very different direction. In the 1930s farming was much more commercialized and market dependent than in the late nineteenth century. Understanding of markets had improved and farmers and politicians perception of the "farm problem" had sharpened. Thus the commodity price support programs established by the Agricultural Adjustment Act of 1933 responded to a different and more focused perception of the relationships between the agricultural and nonagricultural sectors.

It was believed that fundamental economic forces chronically disadvantage agriculture in the market relative to the nonagricultural sectors. Economists argued that in an industrial nation the terms of trade inevitably run against the farm sector. As a consequence, the same bundle of resources earns less in farming than it does in the nonfarm sector. This was perceived by farmers as unfair. Commutative justice requires equal returns for an equal investment of labor and other resources. The price and income parity idea arose out of the concept of commutative justice. The nonfarm public had little opportunity to observe this injustice and thus formed no strong beliefs about it. However, statistics had begun to establish that per capita and family income was lower in farming than in the nonfarm sector. Farmers and their families were easily perceived to be much poorer than the average nonfarm family. This, of course, is the very different matter of distributive justice. This perception of injustice grew stronger over time and elicited support from the rest of society to do something about it.

Finally, it was believed that agricultural markets were subject to far greater instability than nonagricultural markets. This instability was attributed generally to a highly inelastic demand and supply for farm products and to the biological nature of the production process including the perishable or semiperishable nature of many farm products. This tends to make agricultural markets riskier and less efficient than most others. Thus, it was suggested that government stabilization of agricultural markets would produce more efficient outcomes and contribute to societal welfare and development.

This set of factual and value beliefs became the rationalization for government intervention. Such views are reasonably common across industrial countries with developed agricultures. It is not accidental that, without exception, all of the advanced industrial countries protect their agricultural sectors internally and consequently in external trade as well. We shall return to these presumptions later to point out that for the United States none have the same degree of validity today that they had in the 1930s.

## FORCES THAT SHAPE U.S. AGRICULTURAL POLICY DECISIONS

### Actors

There are many actors in the agricultural policy scene. Government agencies, of course, play a number of roles in agricultural policy and in some cases these have changed in recent years.

#### *U.S. Department of Agriculture Agencies*

Today all policy in the USDA dealing with commodities is under the direction of the Undersecretary of Agriculture for International Affairs and Commodity Programs. This arrangement was created in 1969 to coordinate better the agencies involved in trade and domestic commodity policy. Previously these responsibilities had been divided between two assistant secretaries. The position was raised from an assistant secretary to undersecretary in 1978. The undersecretary of agriculture is the primary voice for the secretary in Congress and elsewhere on domestic commodity policy. He is also the secretary of agriculture's primary representative in trade policy negotiations. In the past the undersecretary has played a major role in agricultural trade negotiations, but for the Uruguay Round Secretary of Agriculture Lyng appears to have ceded that responsibility to the United States trade representative in the Executive Office of the President (see below).

Separate organizations deal with domestic and trade matters under the supervision of the undersecretary. The Agricultural Stabilization and Conservation Service (ASCS) administers all of the domestic commodity support programs. Thus it is a primary focal point for all of the commodity interest groups whose product prices are subsidized and subject to supply control. The ASCS is an awesome political bureaucracy composed of a network of state and county offices each with an elected committee of influential commercial farmers from that state or county. These farmer committees play a major role in ASCS administrative and policy decisions. When threatened, ASCS mobilizes this "grassroots" hierarchy of farmers and the commodity groups to defend its interests in the political process in the Congress and with the secretary of agriculture. Many of these commodities involve markets with large exports or imports. Thus, the same interest groups (for example, corn, soybeans, wheat, rice, cotton, sugar, wool) are also equally focused on the Foreign Agricultural Service (FAS) and constitute its clientele and political support. The FAS administers export promotion programs and collects foreign economic intelligence on international agricultural commodity markets. Thus, all of the agricultural counselors and attachés in our embassies around the world are administered by and report to the FAS. FAS does not have any domestic "grassroots" bureaucracy, but depends on national commodity organizations for its considerable political clout. The capacity of the USDA in agricultural trade policy debates is dependent on the analysis and capability of the FAS backed up by research by the Economic Research Service (ERS), which reports to the assistant secretary for economics. ERS does research on commodities and markets and other economic issues but is purely a research and policy analysis agency and has few strongly supportive, politically influential clientele. It is sometimes used by the secretary (and others) to check on the analysis of FAS and ASCS.

There are other policy areas within the USDA that have politically potent "grassroots" bureaucracies or are the focal point for major interest groups. These include the Farmers' Home Administration (FHA), which provides subsidized credit to farmers in disaster situations and when commercial credit cannot be obtained. The Rural Electrification Administration (REA) is responsible for rural cooperatives providing electricity, telephone, and cable TV service in many rural areas. The Soil Conservation Service (SCS) manages the soil and water conservation programs. The Food and Nutrition Service (FNS) administers the Food Stamp and other supplemental food programs. Its primary interest group support includes labor unions and welfare organizations. Since the 1960s the Food Stamp Program has constituted the major trading material that keeps the commodity programs viable in the legislative process.

### *Other Cabinet Agencies*

In addition to the USDA there are at least five other cabinet agencies or organizations that are of relevance on occasion to agricultural policy and agricultural trade policy. The Department of Labor administers agricultural labor regulations, including those for migratory labor. During trade negotiations the Labor Department is the primary voice of labor inside the executive branch. U.S. labor unions were strongly free-trade in their orientation until the late 1960s when they slowly turned protectionist. American labor is generally protectionist in its outlook today.

The Department of the Treasury will also be involved in all trade negotiations and in agricultural policy when financial issues are important. Interest rate subsidies are an anathema, and export subsidies and the means of financing commodity programs generally attract the attention of Treasury. The Treasury has a small group of agricultural economists in their analysis unit.

The Department of Commerce is generally the focal point for business interests in the executive branch. In 1983 there was an effort to transform the Commerce Department into a Department of International Trade and Industry. This failed but it does reflect the level of interest that the Department of Commerce has long had in international trade.

The Department of State has the lead role among the cabinet agencies in international affairs. The State Department is responsible for general intelligence on economic, political, and policy matters in other nations and provides analysis for United States foreign economic and political policy. Thus, it has a major role in trade policy but does not participate in domestic policy except as it has a direct impact on foreign policy. The management of trade negotiations was a primary responsibility of the State Department until 1962, when the Office of the United States Trade Representative (originally the Special Trade Representative) was created in the Executive Office of the President (see below).

The disparate views of the several cabinet agencies must be debated, the information provided analyzed, and considerable winnowing of issues take place before an administration can take a position on an important policy question. In trade policy, as in other areas, this begins in interagency committees. At the cabinet level today the Trade Policy Committee (TPC) chaired by the United States Trade Representative provides interagency coordination. Reporting to the TPC is the Trade Policy Review Group (TPRG) at the assistant secretary level. Below this at the working level is the Trade Policy Staff Committee (TPSC). Since trade issues are not only general questions but most frequently commodity and country specific, the TPSC is organized in geographic as well as functional committees plus task forces on broader issues such as how to deal with centrally controlled nonmarket economies. Participation in these interagency groups varies depending on the subject, the issues, and the domestic constituency involved. The main participants are USTR, USDA, and the Departments of State, Commerce, Labor, and Treasury (Rossmiller, 1984). Recommendations on trade policy go from the TPC to the Cabinet Council on Economic Policy.

The president's cabinet is organized into three policy councils at present: the National Security Council, the Council on Economic Policy, and the Council on Domestic Policy. The Economic Policy Council of the cabinet is the forum through which all major economic policy questions must be processed before going to the president. The Council on Economic Policy includes the Departments of Treasury, Commerce, and State; the president's Council of Economic Advisers (CEA); and the president's Office of Management and Budget (OMB) as a routine matter and other departments as appropriate to an issue. All agricultural policy issues that reach the president flow through the Council on Economic Policy, which is chaired by the secretary of the treasury. The Council's analysis of policy options, recommendations, and remaining conflicts at issue between cabinet officers are summarized for the president's decision.

### *Executive Office/White House*

The White House is staffed according to the preferences of each president. It has no permanent structure for policy. However, the Executive Office of the President contains organizations that have been created by law and may not be eliminated or modified by the president without the concurrence of Congress. The Executive Office includes two agencies already mentioned, the Office of Management and Budget (OMB) and the Council of Economic Advisers (CEA). The Council of Economic Advisers is composed of three (usually) outstanding economists who through the chairman provide advice to the president on economic policy. The Council's primary responsibility is for macroeconomic policy but it also analyzes and participates in any area of policy with significant economic impact. One staff member and one Council member will have the responsibility of keeping track of and participating in major agricultural policy issues including trade negotiations. In most administrations CEA has been involved (at least marginally) in policy for trade negotiations. The importance of the CEA in policy depends on the president's desires and his confidence in CEA. The Reagan CEA appears to have little influence on White House decisions.

The Office of Management and Budget is the president's budget and priority enforcement agency. OMB manages the budget formation process and therefore participates in the policy process. The OMB does not normally have any involvement in trade policy. It does, however, have a seven person unit that in handling all USDA budget matters participates in the policy process in agriculture. Both CEA and OMB have a continuing presence in domestic agricultural policy debates within the executive branch.

Also in the Executive Office is the Office of the United States Trade Representative (USTR), who since 1962 has been designated to lead trade negotiations including the development of the policy position for those negotiations. The present U.S. trade representative is Clayton Yeutter, an agricultural economist and former assistant secretary of agriculture and chairman of the Chicago Board of Trade. USTR was brought into existence in 1962 to bring to an end the interminable bureaucratic fighting between cabinet agencies and the Department of State in trade negotiations. Before the Trade Expansion Act of 1962, the Department of State had the lead role. They subordinated economic policy to political goals and frequently attempted to cut out the other cabinet agencies, the effect of which was to force most decisions, large and small, to the president. This critical institutional change put USTR in the primary leadership role not just in trade negotiations with other countries but also in negotiating with the cabinet agencies to develop the U.S. negotiating position. USTR depends in varying degrees on cabinet agencies for technical and analytical support in carrying out its responsibilities. The influence and formal authority of USTR has grown substantially since its founding in 1962.

### *Interest Groups*

Interest groups represent the various economic and political interests at stake in the policy process. These are highly organized in the United States. Through the 1960s most of the effective lobbies were rather large coalitions that represented functional areas such as business, labor, and agriculture. Before the 1960s smaller interests generally were not well organized and, even if they were, did not have the same degree of access to decision makers as the large economic coalitions. During the 1970s a number of changes in the rules of Congress and the electoral process strengthened single-interest groups and their access and influence. Today the interest group scene especially in Congress is dominated by large numbers of highly specialized, single-interest groups. Interest group lobbyists attempt to maintain close relationships with the committees presiding over "their legislation" and also with the administrators in the executive branch who implement that legislation. When the stakes are high and conflict intense, they often gain access to the Executive Office of the President and even the White House.

The pattern in agriculture is a little different. The general farm organizations (such as the American Farm Bureau Federation and National Farmers Union) characterized the early days of farm interest group influence in the USDA and Congress. But they began to lose out to the narrower commodity interest groups that formed around the commodity price support programs established in 1933. By the early 1950s commodity groups dominated commodity policy. Policy for agriculture soon came to be viewed by farmers and politicians as little more than commodity policy. In most other economic sectors, large coalitions of interests (labor, business) remained reasonably effective until the early to middle 1970s.

The 1933 farm commodity legislation created an "intense interest" among producers. Older or new commodity groups immediately focused on these interests and lobbied relevant congressional committees and ASCS program administrators. Thus was born commodity-based "triangles of power" in agricultural policy. When the interest group leadership, the ASCS administrator of that commodity program, and the House and Senate subcommittee with relevant jurisdiction agree, it matters not what the secretary of agriculture or the president or anyone else thinks about it. They are locked out of the policy process for that commodity by the "triangle of power" and can influence the outcomes only with extraordinary political effort and cost.

Over the 1950s and 1960s farm producer interests, while dominant, were progressively fragmented by the specialization of agricultural production. This led to growing political conflict between and within commodity groups as the interests of farmers diverged commodity by commodity and region by region. When combined with conflicts between agribusiness and farm producer interests it became increasingly difficult to develop a consensus within the previously tight-knit "triangles of power" in agriculture (Heinz). It is a principle of bureaucracy that, as conflict increases and a consensus cannot be reached the locus of decision is progressively forced from lower to higher levels (Downs). In the 1960s, conflict between interests forced agricultural policy decisions toward the secretary of agriculture (for example, the 1961-63 feed grain legislation) and to the president in the late 1960s and early 1970s (for example, the 1965 sugar legislation which was initially drafted in the Executive Office of the President).

From the middle 1960s through the mid 1970s new actors entered the agricultural policy debate. The Bracero (foreign farm labor) Program was killed in 1964 by a coalition of labor unions and churches! The Food Stamp Program began to expand rapidly after it acquired labor union and welfare organization clientele. The 1965 omnibus farm legislation saw the first coalition of farmer, agribusiness, labor, and consumer interests. The legislation passed by a comfortable margin only because of the supporting coalition of diverse interests. Farm and agribusiness groups compromised with others to hold the temporary coalition in place. Labor wanted food stamps available for strikers and to keep food prices low. Welfare organizations were interested in food stamps for the poor and keeping food prices low. The consumer organizations were interested in low food prices, nutrition, and food safety. The consumer interest, however, is so diffuse that consumer interest groups rarely are able to develop broad member support and much political influence.

In addition, in the course of the 1970s the U.S. agricultural sector was internationalized as the nation grew increasingly dependent on the rest of the world economically and politically. The revolution in electronic communications technologies has led to an integration of spatially separate commodity and capital markets into one world market. Capital markets and commodity markets have become increasingly interactive. Events in one immediately affect values in the other--worldwide. Macroeconomic policy changes in any large industrial nation, such as the United States, flow out into the world economy via commodity and financial market transactions just as events and policy change elsewhere create impacts that flow in. There are few closed economies as even the centrally planned nations are discovering. With this growing world economic interdependence the possibility of effective *national* macroeconomic policy declines, and international coordination of economic policy becomes an imperative of stability and growth.

Over the 1970s the nominal value of farm exports expanded more than six times over, while physical volume more than doubled (U.S. Department of Agriculture, 1983, 1985). Most export growth came after 1973 as a consequence of a rapid decline in the value of the dollar, steady worldwide economic growth driven in part by a massive growth in world liquidity as OPEC petrodollars were recycled and lent to developing countries, plus low and often negative real interest rates in many countries as a result of the exchange rate and monetary policies pursued. At the same time the United States had millions of acres of idle land available that had previously been withdrawn from production by supply controls. Thus, not only did exports grow but the United States market share of world agricultural exports expanded. A bad crop year over a large part of the world, plus a change in the agricultural policy of the Soviets created a one-time surge in prices for 1973 that was epic. The USSR traditionally slaughtered livestock it could not feed in bad crop years. But in a policy reversal they suddenly began to import grains following a severe crop failure in 1973 (Rossmiller, 1986). This cumulative set of events imposed a heavy burden on world grain supplies just as all of the excess stocks accumulated in the 1960s had been absorbed as imports by rapidly growing middle-income developing countries (Hathaway, 1974).

As these changes have occurred, power shifts have followed within the executive bureaucracy and among interest groups. When it became necessary to form coalitions with labor, consumer, and welfare interests in order to get agricultural legislation passed, the USDA's Food Stamp Program became trading material, and the assistant secretary responsible became politically more influential. The food stamp policy area simultaneously became a scene of considerable conflict over whether the farmers' department should be the host for and champion of a "welfare program." This cut across the grain of farmers' long-standing belief that every individual should be independent and self supporting.

The growth in farm exports has brought new interest groups and bureaucracies into the fray in agricultural policy. These include export organizations and their cooperators as well as financial interests. The United States Trade Representative and the Departments of Treasury and State are routine actors in agricultural policy. When food has been used as a weapon of economic warfare in embargoes, the Central Intelligence Agency and the National Security Council have been drawn into the policy decision process.

An index of both the relative strength and weakness of agricultural commodity groups is found in the successful efforts of a coalition of major commodity groups to force the American Farm Bureau Federation (AFBF) to change its long-held free market philosophy as expressed in the formal statement of AFBF policy. At two successive biennial AFBF national conventions during the 1980s, these commodity groups, many of whose members are also AFBF members, pressured AFBF (threatening a politically costly floor fight) first to gain AFBF political commitment to price supports and then, two years later, to the target price-deficiency payment feature of commodity programs. While this event reflected the greater power of the commodity groups relative to general farm organizations, it was motivated by the declining power of commodity groups to sustain commodity support legislation and thus their need for a stronger, more unified producer coalition. Other general farm organizations such as the National Farmers Union and the Grange were already supportive of the commodity programs.

### *The Media as an Actor: The Struggle to Manage Public Opinion*

Perhaps the most remarkable change in the U.S. political process in recent time is the intrusion of the media as a participant. The media became a political actor in the last several decades as the press combined with television began to affect political and policy outcomes. The media has captured two of the most critical functions of the political party, access to voters and the setting of national, political, and policy agendas. We tend to think that more information leads to better decisions. But the electronic media have characteristics that contribute to chaos by maximizing conflict, while minimizing the capacity for decision or conflict resolution. The entrance of the media as a political actor has greatly compounded the uncertainty and conflict introduced by the other changes already described.

Television, and to a lesser extent the print media, oversimplify issues, and the facts never catch up with any errors or distortions. They live on and stress sensationalism and even advocacy in presenting public issues. This practice arises out of the financial need to maintain a maximum share of the audience in order to sustain advertising revenues. The media tend to personalize public issues. On television there is a villain with an evil design behind every failure and a hero behind every success. The media fosters an endemic cynicism that nothing is as it seems. The apparent explanation always hides some lurking evil or malicious plot. In reality most man-made disasters arise not out of plots but from human inattention, stupidity, confusion, ignorance, and incompetence. Thus, the media by its nature fosters a public cynicism that erodes the authority and denigrates the leadership of all institutions it touches. Television in particular turns campaigns and public issues away from their substance toward visual "media events" that personalize, sensationalize, and ultimately trivialize political issues.

The advent of network television has shifted the focus of the news toward national and away from state and local affairs. There is not only a new focus (and agenda setting capability) but new audiences. Television, primarily an entertainment media, has brought from local into a national level existence blue collar and other nonelite audiences. This has not only had an impact on advertising but has also changed the political process and national opinion formation. Previously access to the formation of national public opinion and policy had been generally limited to national elites (Robinson).

Television tends to be inherently antiestablishment in its impact. This is due to the combined effect of the public cynicism it generates about existing institutional authority, its wide audience impact, and its symbiotic and emotional audiovisual nature (Robinson). In essence television does not inform, educate, or communicate ideas (especially complex ideas) but rather transmits broad images and values which an audience resonates with, responds to, or acts on. It is not an education media but an emotional and symbolic one. And politics has been transformed by it.

Electronic communications have accelerated many social and political trends that would have otherwise occurred much more slowly. The response time for dealing with issues has been compressed and the public agenda cluttered with more issues than politicians can safely manage, while taking away from politicians the little control they had over the agenda. Television has changed the dynamics of the interaction between the actors and thus directly affects policy outcomes. By controlling the agenda and access to voters, and by changing the nature and the speed of the interaction that occurs in policy and political processes, the electronic media, especially television, have become a direct and often destabilizing participant in the policy process.

Other actors now invest an immense effort and many resources in media management to influence the headlines and control what shows up on the evening and morning news. Candidates for office and office holders create media events to gain visibility or to squeeze other items off the news. "Spin control" is a media management art form practiced in today's White House and in each cabinet secretary's office to put a positive face on negative events and self-inflected wounds.

The media had a substantial influence in assuring passage of the Food Security Act of 1985 in a form that preserved and expanded commodity price and income supports. The "farm crisis" of 1983-85 was the inflamed context in which this Act was debated and enacted. The media personalized the "crisis" with interviews of bankrupt farmers and their families, often in tears, and against the background of the auctioneers' chant. By the end of 1985 the average TV viewer had the impression all or nearly all farmers were going out of business. In fact the vast majority were doing reasonably well and were in no danger of going under.

Grassroots, small family farm advocacy groups, following energetic media strategies, generated most of the original media attention. They hoped to have a major impact on the 1985 legislation; however, in the end most of the benefits of the legislation, as in the past, went to commodity interest groups and their large commercial farm members. But the political heat generated assured renewal of the commodity programs in the most expensive format in history.

## POLITICAL DYNAMICS

### Presidential and Congressional Conflict

Canadian and U.S. governance institutions differ fundamentally. The United States is not a parliamentary system. The executive and legislative branch are not tied together by the electoral process. The president, senators, and members of the House of Representatives all have fixed terms of different lengths and are elected from separate constituencies. The president has a national constituency and is elected every four years in a nationwide vote. Senators are elected for six-year terms from an entire state with the size of population and political composition of states varying greatly. Representatives are elected every two years from 435 districts of about equal population within the fifty states. The Constitution forbids senators and representatives to serve simultaneously in the legislative body and the president's cabinet. Before being appointed to head a cabinet agency they must resign from Congress.

The Constitution of the United States establishes the legislative, executive, and judicial branches of government as separate institutions but then gives them shared authority. As Richard Neustadt has explained, this means that the power of the president and of all other constitutional actors in this system is only "the power to persuade." That is, if you must collaborate to act effectively then your power is only the power to persuade other actors to join you in support of your version of the action needed. Persuasion thus becomes bargaining (Neustadt).

The primary goal of the founding fathers was to diffuse power broadly to avoid its concentration and to provide checks and balances to its exercise. The U.S. system is designed to be generally more responsive to small local groups and interests in the body politic. Consequently, U.S. national policies will more frequently lack coherence and consistency. The parliamentary system, on the other hand, is normally organized to assure a sufficient concentration of power so that effective governance is possible. The European historical experience more often has been one of fragmented political parties of substantial ideological difference, frequently with an insufficient concentration of power to govern. The rules of many of the parliamentary democracies are written to assure that concentration of power needed to overcome political fragmentation and ideological conflict.

The typical congressman cannot afford to think any further down the road than the next election. Most of his action in Congress is calculated in terms of its effect on his reelection, which is never more than two years off. His agenda is dominated not by national but parochial interests and whatever distribution of power exists within his district. Senators, who are elected for six-year terms, will tend to take a slightly broader and longer run view. The president will appeal to a national constituency of voters and interests, often over the head of the Congress, for support of his agenda. United States electoral campaigns have grown to about two years in length. This means House members are in a perpetual campaign mode. The cost of election campaigns is now so great that even senators and a president must begin raising money for reelection, the moment they are elected. "Money talks" in politics and never more loudly than today. Needless to say, none of this is conducive to statesmanship or thoughtful policymaking.

Thus, to establish a new policy, one must fight a political war all the way through the executive branch, the House of Representatives, and the Senate, having to face in each quite different agendas, political actors and distributions of power. A diplomat representing another country is shocked to learn that it is not enough to deal with the president of the United States and his cabinet officers; that the president cannot enforce his promises unless the Congress agrees. And Congress frequently chooses to disagree. The astute and successful Iraqi ambassador, Nizar Hamdoon, has observed:

> My first advice to any ambassador here is don't spend more than five percent of your time with the administration. There are limits to its power. Anything you agree to with the administration, despite any guarantees, means nothing if Congress and public opinion are not with you (Kempe, 1985).

It runs against the grain for diplomats from parliamentary nations to lobby our legislative branch. In a parliamentary democracy that would be interfering in a president's domestic political affairs. Yet it is necessary and, when done with discretion, is effective and accepted behavior in the United States.

The other consequence of the U.S. governance system is that nothing is certain. One may start out with a substantial consensus but in the year to two years that it takes to get something completely through this process, the context of a decision can change, the actors can change in some cases, and the interest group configurations that cluster around any particular issue can change. Thus, there is a continuing guerilla war that must be fought over any one piece of legislation. Negative power predominates in the U.S. policy decision process. In the present fragmentation of power, it is far easier for a legitimate interest to prevent any change in policy than to establish a new policy. Trade policy is just a small contingent subset in this scene.

### Trade-offs with Other Issues

It is always true in a democratic legislative body that log rolling, trading of support on issues, is an important political behavior. In the American governance system, this is of special importance. The only way that actors can deal with each other effectively is through bargained agreement in forming coalitions to get legislation through. The same is true with respect to other agendas. In other words, the president will have an agenda that is quite different from that of any member of Congress. Interest groups will have even different agendas. There are many possibilities of coalitions being formed and tradeoffs occurring between the actors and their various agendas. Thus, it matters substantially what other issues exist when you mount any specific legislative effort or when you lobby the executive branch. This causes one to think carefully about timing as well as the configuration of issues.

### Local Economic Interests versus Foreign Policy

A common characteristic of the U.S. system of governance is of particular relevance to treaties and any foreign policy effort. Due to the openness of the system to all economic interests no matter how small, and, due to the manner in which representatives and senators are elected and the parochial nature of their interest, one cannot expect members of Congress to view foreign policy or a treaty simply as a matter of national interest and vote on that basis. When local economic interests come into conflict with foreign policy, one must assume that the odds always favor the domestic economic interest. This is normally true in most democracies, but it is especially the case in the fragmented political scene today in the United States.

### Institutional Changes: Reform of Electoral, Party and Congressional Rules

The Congress is a major, independent partner in all policy made in the American government, including all trade negotiations. In the Reciprocal Trade Agreements Act of

1934, Congress removed trade policy from congressional purview (to provide some insulation from interest group influence) and assigned it to the president. Since World War II, but especially since the early 1970s, in the conflicts between Congress and the presidency Congress has reasserted and extended its role in foreign affairs including trade policy. While it never ceded any of its authority in domestic agricultural policy, Congress has been more or less active depending on the political context and the personalities involved.

The primary focus for agricultural policy is the agricultural committees of the House and Senate where all legislative matters are handled. In addition, since appropriations to implement any policy are handled separately by the Appropriations Committees of the House and of the Senate, there is an agricultural subcommittee in each of these committees that has a major voice in the policy process. International political affairs are in the hands of the Foreign Affairs Committee of the House and the Committee on Foreign Relations in the Senate but any legislation concerned with international trade would be managed by the international trade subcommittees of the House Ways and Means Committee and the Senate Finance Committee. It should be pointed out that in any legislative matter the Rules Committees of the House and of the Senate make a decision as to which committees proposed legislation will be referred. Thus any piece of legislation could be referred, not just to the obvious committee, but to others, if strong enough interest is expressed by other committees and enough political influence is mobilized to move the Rules Committee to do so. The committees concerned with commerce and with labor issues will usually be involved in trade legislation. The committee structure is not a totally certain road map of how legislation might be handled in the Congress. It depends on the politics of it and what the Rules Committees do.

In addition, the Joint Economic Committee (JEC) of Congress, which has no legislative authority, can hold hearings and advise any other committee on legislation. Also the Congressional Budget Office (the Congressional equivalent of the OMB in the executive branch) and the Congressional Research Service of the Library of Congress have staff who, when requested by Congress, can do analysis of agricultural legislation including trade issues.

The old concentrations of power in Congress and the executive branch and the stable coalitions that once formed the base of the political parties through the early 1970s are gone. The old system and the old way of doing business have disappeared. We are now in transition to something as yet unseen, presumably to some different way of making the political system work. Today this creates a great deal of uncertainty and even instability in U.S. policy processes.

Why has this change occurred? In part, it arises out of the effects of changes in societal values and the new electronic communication technologies. But it comes most directly from changes in the rules governing our political institutions. These reforms have combined with the other changes to fragment the political and policy decision process and the institutions by which the United States is governed.

The reforms arose out of a major societal crisis. It began with the trauma of Vietnam and the imperial presidencies of Lyndon Johnson and Richard Nixon. It was compounded by the Watergate scandal and the assassinations of President Kennedy, Robert Kennedy, and Martin Luther King and the attempts on the life of Governor Wallace and President Ford. With the media's help, these events created a belief that our political institutions had failed and spread a cancerous cynicism about all authority, especially in government. It dissolved the stability of the depression-born political consensus and the reigning social and political values of our society. It led to a reform of the primary election process and of campaign financing, to a reform of the parties and their rules and to a reform of the Congress and its rules.

The purpose of these reforms was to open up and make more responsive and accessible what was perceived as a closed and unresponsive political system that no longer had the legitimacy of broad citizen support. The reforms did open the political process to all of its frustrated critics and to anyone who wanted to "participate." It hardly seems objectionable to make a democratic political process more democratic. However, the effect of dismantling the old system has not only been to open up and democratize the political process but also to destabilize it by magnifying conflict while reducing the institutional capacity to resolve conflict. This has occurred at all levels of political and policy decision.

The creed of participatory democracy asserts that unless every one in the electorate has the opportunity to participate in all political and policy decisions, those decisions are not legitimate. This substitutes the New England town meeting concept for that of Edmund Burke's democratically elected representative, or representative democracy. The critical assumption is the belief that all voters are well enough informed to be capable of good judgment in complex matters and are equally able to participate.

The changes in rules to implement participatory democracy involve substitution of popular voting in primaries for party selection of candidates in state and local party caucuses and conventions. The United States is the only democracy today where the party does not select the candidates to represent that party in elections. This turns national party conventions into redundant media events and removes the party as an effective participant in the governance process. Since parties have been the glue that historically has held together the constitutionally created institutions of the governance process, this change has important destabilizing effects.

The change in electoral financing rules limit large political contributions but have provided the incentive for interest groups to create thousands of political action committees (PACs) with computerized mailing lists that support or oppose candidates in elections. This, plus the need to merchandise one's candidacy on television, has escalated the cost of elections, and given single interest groups a privileged position of influence.

Congress reformed its rules to distribute power more evenly to all senators and representatives, while removing it from the leadership and the committee chairmen. With this has come an explosion in the number of subcommittees. Thus, instead of twenty to thirty barons running each house of the Congress, all 100 senators and nearly half of the 435 representatives hold formal positions of authority but few control much of anything. Complicating this is a more than six-fold growth of congressional staff from around 6,000 in 1947 to 38,000 in the mid 1980s. Congress now has so large a bureaucracy that its propensity for creating unnecessary conflict and confusion now may exceed that of the executive branch. In Congress today, staff members make many of the decisions, manage the decision process, and often tell their boss how to vote. Unlike the executive branch, there is no hierarchical command structure for managing the congressional bureaucracy. Each representative and senator does well to control his or her own staff.

Congressional reform has resulted in so great an increase in single-interest-group access to Congress that policy outcomes are now dominated by a buzzing swarm of interest groups. As a consequence most legislation, no matter its camouflage, is special interest legislation. The Congress, which was never good at controlling expenditures, has almost completely lost control of its appropriations process. Ease of access, combined with a lack of power in major leadership roles, turns Congress into little more than a battlefield on which an unending, often indeterminate struggle takes place between interests.

We have greatly increased the transaction costs of doing the nation's business. Stable decisions and the national interest increasingly elude us. Narrow economic and political interests dominate the decision process, most clearly in the Congress, but also in the executive bureaucracy. The political parties are now so weak as almost not to exist. The shift in political values from representative to participatory democracy has increased the disorder in basic political institutions and has led to a very unstable decision process for all policy.

## CONCLUSIONS

The uncertainty and diffusion of power so pervade the U.S. political and policy processes today that policy outcomes contain many accidental, even random, elements. Negative power, the ability to block another's initiatives, predominates. Few, if any, actors have the strength to extract just what they want out of the process. The positive power to establish a completely new policy in agriculture (for example, as proposed by the administration in 1985) does not seem to exist. On one hand, while one may safely predict that major changes in policy are unlikely to occur, it is almost impossible to predict or anticipate the many marginal modifications of policy that seem to occur nearly at random.

The presumptions underlying agricultural policy are no longer as factually valid nor as widely believed. The resources and labor invested in the largest commercial farms now earn on average as much or more than the same resources invested in most of the nonfarm business sector. The smaller commercial farms still frequently earn less. Thus, the commutative justice argument has eroded. The distributive justice argument is completely unfounded today; on average farmers of all sizes (including noncommercial farms) earn net incomes (from all sources) that match or exceed those of the nonfarm sector. Commercial farmers also own far more in assets than the nonfarmer. Farmers as a class are no longer poor. The only "people left behind" in rural America are the smaller commercial farmers without significant nonfarm income, who are being squeezed out by the technological treadmill, and the rural nonfarm population in areas dependent on a declining economic base in manufacturing, agriculture, forestry, and/or mining.

Finally, the argument that government intervention in agricultural markets is justified by the greater instability and risk of those markets has also eroded since the 1930s. Not only are there now available alternatives such as futures markets and insurance, but contracting, vertical integration, and concentration of production have altered the structure of many markets. New production technologies and scale of operation have eliminated or reduced many of the risks in production agriculture. While production and market risks remain, the major risks today would appear to arise out of the unprecedented international interdependence of commodity and capital markets and from the impact of U.S. fiscal and monetary policies as well as those of our major trading partners.

Popular perceptions of agriculture, and thus support for farm policy, have not changed much yet, but they are bound eventually to reflect the new reality of equity and the markets in agriculture. Thus, while the prospect for a broad shift toward free trade seems unlikely in the short run, in the long run major changes in U.S. agricultural policy are almost certain, as the reality of these markets and of the welfare of farmers becomes more widely understood.

While the current administration is free trade and anti-government-intervention in its orientation, the Congress has become increasingly protectionist and begun to take a larger role in trade issues. Since World War II, and more rapidly since the mid 1970s, Congress has reestablished a major aggressive role for itself in trade policy, as it has in foreign policy generally.

The environment of U.S. foreign policy has changed dramatically in the last decade or two. As a consequence the focus of U.S. foreign policy has shifted from political and military goals toward economic goals, which are no longer being sacrificed as readily to the other two. The reasons for the greater importance of economic goals are found in the fact that the United States is no longer the single dominant economic power in the world. The United States has as well moved from trade surplus to deficit and from being the world's largest creditor to its largest debtor nation. Economic goals become far more important when you get into this much economic trouble. While policy coordination or harmonization has become more difficult in today's interdependent world, it is worth the effort because macroeconomic and trade policy are more important determinants of farmer, agribusiness, and consumer welfare today than most conventional elements of agricultural policy.

Where are we headed? I frankly do not know. It is possible to visualize some very different scenarios. One is the United States' withdrawal from international leadership into a new isolationism, retreating in frustration and failure from political and military commitments around the world. The United States could, in its senescence, be replaced eventually by Japan, much as the United States replaced Britain as a superpower in the early part of this century. It is also possible to envision a dangerous, frustrated "Rambo" posture of repeated overreaching militarily, politically, and economically until disasters result. With strong, intelligent leadership in the White House and Congress, it is also possible that the United States could shoulder its share of responsibility in a genuine coalition of industrial and developing nations and attempt to build the international institutions and cooperation necessary to harmonize national policies in the interest of economic growth and stability. I would not want to place any bets.

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# DRIVING FORCES, INSTRUMENTS, AND INSTITUTIONS IN CANADIAN AGRICULTURAL POLICIES

**H. Garth Coffin**

## INTRODUCTION

One of the challenges of freer trade is harmonization of national policies. It is important, in considering the need and prospects for harmonization, to understand the reasons for a particular policy response and how firmly entrenched it might be. This is especially relevant in the context of Canadian-U.S. agricultural trade, where similar kinds of problems in each country have often evoked a somewhat different policy response.

An examination of the driving forces, instruments, and institutions provides a useful context in which to understand factors that have influenced the formation of Canadian agri-food policy. This process has been broadly defined by Forbes, Hughes, and Warley as follows: "Farm and food policies emerge from a complex interaction of societal values, beliefs, environmental factors, goals and objectives, and the characteristics of policy instrumentalities. Each of these has economic, social, and political dimensions" (p. 16). In order to understand more clearly the dynamics of policy formation, it can be considered that:

(a) Policies exist because of problems which, together with objectives, constitute a major element in the set of *driving forces*

(b) *Instruments* are chosen according to the nature of the problem and the objectives sought, both of which reflect the economic environment

(c) *Institutions* are selected or created to implement policies and programs, depending on the nature of the problem and the instrument chosen to apply to it.

These basic linkages are illustrated in figure 1 by the solid lines. Of course, relationships and dynamics are not that simple. In almost all cases there are reverse flows of influence. For example, a particular instrument chosen to solve a problem at one level may contribute to problems elsewhere and thus become a driving force for other policies. Similarly, an institution created to apply a particular instrument may take on a life of its own with a survival instinct that itself becomes a driving force. Likewise, the presence of certain institutions may influence the choice of policy instruments to deal with a particular problem. These reverse flows are illustrated by the broken lines in figure 1.

Figure 1 also contains a partial listing of the main driving forces, instruments, and institutions that may be important to this analysis, some of which will be discussed in this paper. These should, however, be regarded as illustrative rather than definitive.

Before proceeding to investigate the driving forces behind Canadian agricultural policy in more detail a brief digression on the evolution of that policy is in order.

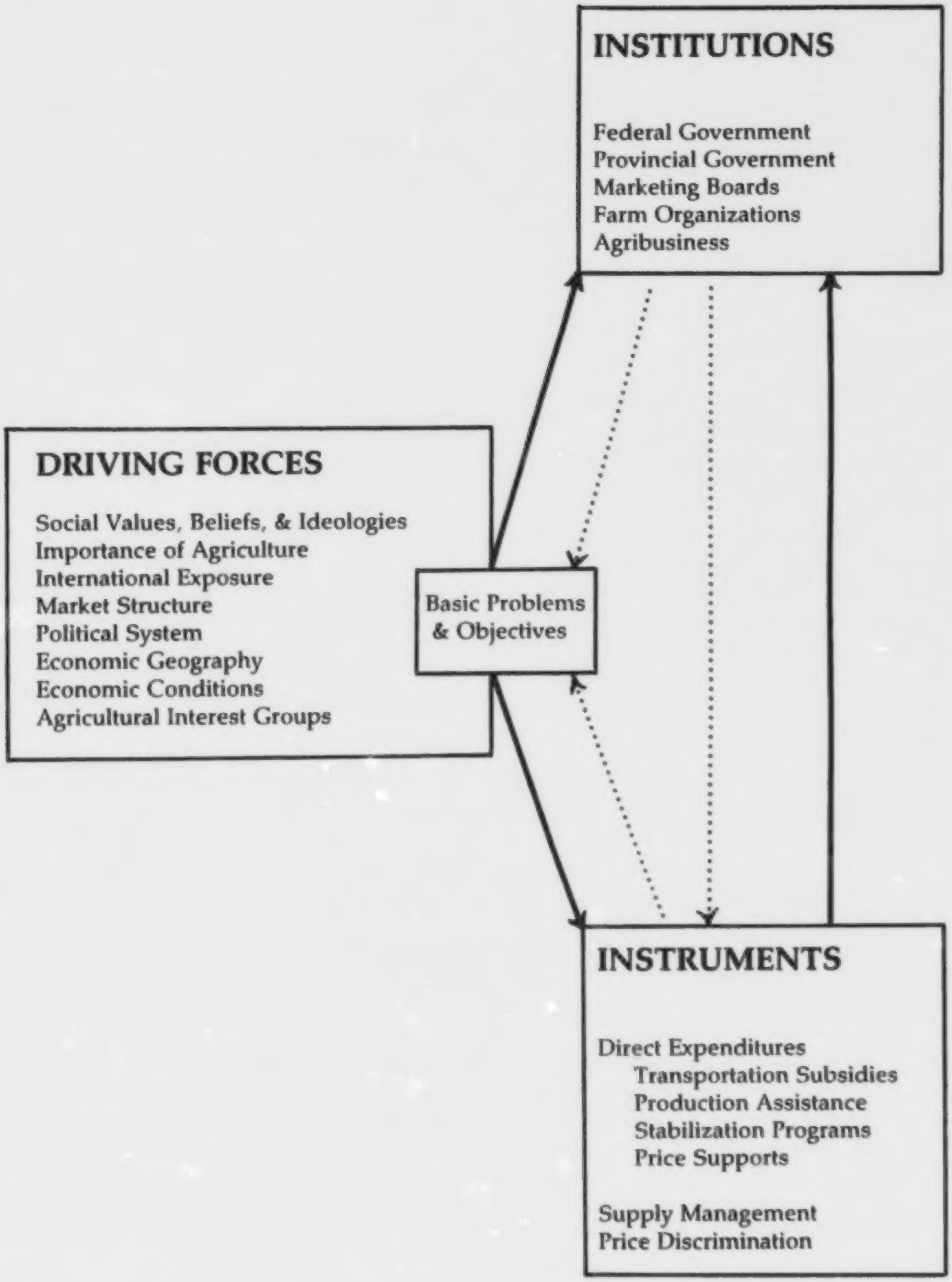

FIGURE 1. Linkages among driving forces, instruments, and institutions in Canadian agricultural policy.

## THE EVOLUTION OF CANADIAN AGRICULTURAL POLICY

The history of Canadian agricultural policy and the evolution of objectives and instruments over time are well documented in a number of studies. Drummond, Anderson, and Kerr (1966) traced the development of policy in five successive stages from the early settlement of the country to the 1960s. These authors concluded that issues pertaining to resource use had been underemphasized and called for more attention to manpower and land-use policies and "a coordinated system of regional development which would maximize the competitive strength of Canadian agriculture."

Menzie (1980) builds on the foundation laid down by Drummond, Anderson, and Kerr and extends the review of policy through the 1970s. He argues that there has been a basic persistent theme in Canadian agricultural policy as farmers have struggled for greater bargaining power, improved income security, improved income parity relative to the rest of the economy, and continuance of the family farm. He also argues that the Canadian farmers have been relatively successful in realizing these goals through legislation supporting cooperatives, marketing boards, and price stabilization.

Barichello (1986) extends the review of Canadian agricultural policy in the 1980s with emphasis on those policies of particular interest to the United States. He observes that Canadian policy displays "a larger real commitment to stability than one finds in U.S. agricultural policy" and devotes considerable attention to a review of stabilization policies. Barichello also contends that large income transfers from consumers to producers through marketing boards and supply management programs are inefficient methods of solving the farm income problem.

Citing Warley's classification of policy objectives into two broad categories, Barichello argues that the group of "protectionist, preservationist and adjustment-ameliorating" objectives has gained in importance since 1970 relative to those that are "development-oriented, productivity-enhancing and competitiveness-promoting." Both Warley and Barichello observe that there has been a tendency to broaden the scope to "agri-food" policy rather than agricultural policies, bringing consumer and food industry interests into the picture along with producer concerns (Warley and Barichello, 1986).

Another development in Canadian agri-food policy in recent times has been the larger role played by provincial governments. Although the authority for intervention in certain areas has always been there, most provincial governments have been more aggressive in exercising that authority in the past two decades. This is particularly noticeable in the traditionally federal areas such as income stabilization and marketing, where provincial involvement is required for effective supply management. This has created more need for consultation and coordination among different levels of government within Canada in the making of agricultural policy.

A recent study by the Economic Research Service of the U.S. Department of Agriculture shows that the United States and Canada have arrived at about the same aggregate level of support for agriculture--a weighted average aggregate producer subsidy equivalent (PSE) of about 23 percent (U.S. Department of Agriculture, 1987). But each country has chosen different ways to get there. In Canada we have used more direct market intervention in the form of marketing boards and supply management but less direct subsidization, especially in recent years. We have also offered broader commodity coverage in major areas such as stabilization programs for beef and pork and supply management for the poultry sector (see Blandford's and Huff's papers in this volume for a more complete discussion of PSEs). It may further be observed that intervention in agriculture in Canada has been more stable and consistent over time than has that in the United States and is much more decentralized in terms of the levels of government involved.

## DRIVING FORCES

In a 1987 study, Gardner uses a partial equilibrium market model to test the strength of association between certain driving forces and the level of support in his innovative approach to quantifying the "causes of U.S. farm commodity programs." He describes farm programs as income redistribution measures. Demand for these programs is a function of the costs to producers of generating the necessary political pressures (lobbying), and supply is a function of social cost (deadweight loss) of the programs. Gardner concludes that the level of intervention is inversely related to deadweight loss, positively related to the import and export position of the commodity, and nonlinear with respect to the number of producers. Although no attempt is made here to model the Canadian experience in a similar fashion, his findings provide useful guidance in exploring the driving forces behind Canadian agricultural policies.

### Social Values, Beliefs, and Ideologies

Social values, beliefs, and ideologies all exert a powerful influence on policy response to economic problems. They define and order the feasible set of instruments and institutions as well as guiding interpretation of the problem. They therefore determine whether any action will be taken and what form that response may take. There are many similarities between Canada and the United States in this respect.

Both countries operate as modified market economies, guided by the principles of free enterprise, constrained by government incentives, disincentives, and regulations, with systems of transfer payments to compensate for market failures. Social values reflecting preference for orderly change, acceptance of lobbying by interest groups, respect for policies produced by the democratic process, and belief in distributive justice as reflected in both social need and economic contribution are common to both countries. The beliefs of society in the nature and reality of the problems facing agriculture and the merits of the family farm as the basic social and economic unit of agriculture do not differ appreciably between Canada and the United States.

Members of the farming community, as much if not more so than other members of society in both countries, place a high value on the freedom to make their own economic decisions, and much prefer market returns to government handouts. Acceptance of transfer payments in lieu of adequate market prices, yielding certain freedoms (as under supply management), or lobbying for more favorable policies are, for most, disagreeable alternatives that reflect a serious loss of confidence in the free market system in much of agriculture. But, once having been fought for, these policies will be defended. There is little difference between Canada and the United States in this respect which is not explained by factors other than ideology.

If it appears, for example, that there is greater reliance on the free market in the United States than in Canada (and that is open to debate), it may be due to a lower incidence of market failure in the United States rather than a major difference in ideology. Similarly, if Canadian policy reflects a greater importance attached to equity among producers, it may be attributed to more concentrated market structures where equity is more threatened in Canada rather than socialistic tendencies of the Canadian population.

On the other hand, there is also evidence of differences between the two countries in this area of social value and ideologies. Many would argue that public support for socialized health care and other social welfare programs, together with lower military spending, and the involvement of crown corporations as commercial entities in petroleum, transportation, communications, finance, manufacturing, and marketing are indicative of a different set of social values and ideologies in Canada. There may be less fear of big government in Canada because government power is much more decentralized than in the United States. These differences, though they exist, should not be overemphasized.

### Basic Problems

The main driving force behind any specific national policy must be the problem to which it is addressed. Basic problems confronting Canadian and U.S. agriculture are similar. Farmers in both countries have been challenged with structural adjustment associated with technology adoption--first mechanical and then chemical--since the 1940s; they have had to cope with chronic surpluses and depressed prices and incomes in the late 1960s and again in the 1980s; they have been buffeted by highly unstable markets and prices, accompanied by rapid inflation in the 1970s and followed by continued high input prices, depressed product prices, and declining asset values in the 1980s.

The policy response to those basic problems is also shaped by certain objectives and constraints associated with other industry characteristics and the system of government. The objectives are discussed below.

### Objectives

Most statements on Canada's goals and objectives for agricultural policy refer to concepts such as (1) an adequate, dependable supply of high quality food at reasonable and stable prices; (2) fair and stable returns to farmers and reduced economic disparities; and (3) increased efficiency, conservation of natural resources, economic development, improved quality of rural life, and contribution to world food supply (Agriculture Canada, 1977). These expressions reflect the broad interests of consumers, producers, and the national economy.

More to the point in the context of Canada/U.S. comparisons, however, is how the relative importance of specific objectives may differ and how this may influence the choice of policy instruments. In this regard, as explained below, Canadian agricultural policy reflects a greater importance assigned to the objective of producer equity, which favors more direct intervention, and the selection of instruments that enhance the bargaining power of farmers. The export position of agriculture and the economic geography of the country give importance to objectives of competitiveness and regional development and favor the choice of instruments such as transportation subsidies. A higher degree of international market exposure in Canadian agriculture also increases the importance of income stabilization. These are ways in which the characteristics of agriculture influence the objectives which, in turn, influence the choice of instruments.

### Agriculture's Importance in the Economy

There is a general notion that the greater the contribution of a particular sector to a national economy, the more responsive government will be to its policy needs. On a national basis, most measures of agriculture's importance show it to have slightly more importance in Canada than in the United States. In its contribution to aggregate economic activity for example, agriculture accounted for 3.7 percent of gross domestic product (GDP) in Canada in 1983 versus only 1.9 percent in the United States. Similarly, a higher proportion of the total labor force is employed in agriculture in Canada than in the United States, and agricultural exports make a relatively greater contribution to the balance of payments in Canada.

These differences are not great. The economic importance of agriculture at the regional level may have a more significant impact on national policy, especially given the political system in Canada. Both regional specialization and distribution of production serve to reduce the cost and increase the effectiveness of political organization in the farming community. Two of the most highly supported sectors, dairy and cereals, are highly concentrated in central Canada and the Prairie Provinces, respectively. In addition to reduced cost of political organization this situation contributes to regional competition for public funds based on some notion of fair play in the distribution of federal support. In other words, the amount of federal support for industrial milk production, 40 percent of which is located in Quebec, is sometimes used as an argument by those seeking more support for grain production located largely in western Canada. Regional and commodity distribution of farm cash receipts which contribute to those pressures are shown in table 1.

## International Exposure

The extent to which an industry is integrated into the international marketplace may influence both the need for policies and type of policy action a government may take. Gardner found that imported goods received a higher level of support than nonimported goods in the United States but that support also increased as a larger share of production was exported. He found the latter result consistent with the notion that high export share permits part of the cost of commodity programs (such as acreage controls) to be transferred to foreign buyers through higher prices.

By most common measures, Canadian agriculture is more highly integrated into the international marketplace than U.S agriculture. For example, on an aggregate basis, the value of agricultural exports corresponds to nearly half the value of farm cash receipts in Canada as compared to only 20-25 percent in the United States. Similarly, the value of imports is equivalent to about 30 percent of farm cash receipts in Canada versus 14 percent in the United States.

The degree of exposure varies across commodity groups, reflecting both the competitive position of particular commodities and the presence of import restrictions in certain cases. As is well known, the dairy and poultry sectors are the most highly protected in Canada, with exports and imports at less than 10 percent of farm cash receipts. All other major commodity groups show exports equivalent to at least 30 percent of farm cash receipts, and in the case of cereals and oilseeds the ratio runs as high as 95 percent. Imports are also large in most cases (except grains), often competing directly with Canadian products. The ratio is highest in fruits and nuts where imports are valued at five times the level of farm cash receipts for Canadian products. Because of climatic factors, of course, a substantial portion of fruit and nut imports consists of noncompeting products insofar as Canadian agriculture is concerned.

Comparisons relating export and import value to farm cash receipts do not allow for differences in value added associated with changes in product form. For this reason, it is also useful to look at the international orientation of the food and beverage manufacturing sector. Again, we find the Canadian industry is more highly internationalized than is the U.S. industry. To illustrate, exports by Canadian food and beverage manufacturers in 1982 represented 9.2 percent of their total shipments versus only 4 percent of shipments exported by U.S. manufacturers. Similarly, imports of manufactured food and beverage products in 1982 accounted for 8.7 percent of the domestic supply in Canada as compared to only 3.5 percent in the United States (Lanoie, 1985).

This performance by the Canadian industry might be considered all the more remarkable given that, on average, U.S. food and beverage manufacturing establishments

TABLE 1. Distribution of Farm Cash Receipts by Commodity and Region in Canada, 1986

| Commodity group | Total ($ million) | Distribution (%) | Regional shares (%) | | | |
|---|---|---|---|---|---|---|
| | | | Atlantic provinces | Quebec | Ontario | Western Canada |
| Cereals[a] | 5,677 | 28.1 | 2.2 | 3.8 | 7.8 | **86.2** |
| Oilseeds | 1,061 | 5.2 | -- | -- | 21.4 | **78.6** |
| Potatoes | 272 | 1.3 | **36.8** | 15.0 | 14.2 | 34.0 |
| Fruits | 267 | 1.3 | 9.6 | 14.9 | **39.6** | 35.9 |
| Vegetables | 573 | 2.8 | 4.6 | 18.1 | **57.2** | 20.1 |
| Other crops[b] | 1,224 | 6.1 | 3.1 | 7.9 | **63.3** | 25.7 |
| Total crops | 9,076 | 44.9 | 3.5 | 5.4 | 21.2 | **69.9** |
| Cattle and calves | 3,553 | 17.6 | 2.4 | 8.2 | 32.9 | **56.5** |
| Hogs | 2,095 | 10.4 | 4.0 | **31.9** | **31.8** | 23.3 |
| Dairy | 2,779 | 13.7 | 6.2 | **36.3** | **34.5** | 13.0 |
| Poultry and eggs | 1,435 | 7.1 | 8.2 | 24.7 | **37.0** | 31.1 |
| Other livestock | 215 | 1.1 | 12.9 | 16.1 | 29.8 | **41.2** |
| Total livestock | 10,078 | 49.9 | 4.8 | 23.4 | 33.7 | **38.1** |
| Other cash receipts[c] | 1,060 | 5.2 | 2.7 | 33.5 | 15.7 | 48.1 |
| GRAND TOTAL | 20,215 | 100 | 3.5 | 15.9 | 27.1 | 53.5 |

*Note:* Bolded figures indicate leading region (or regions) for each commodity.

*Source:* Data from Agriculture Canada, *Handbook of Selected Agricultural Statistics*, 1986, Ottawa.

[a] Includes Western Grain Stabilization and crop insurance payments.

[b] Includes tobacco, sugar beets, floriculture and nursery, etc.

[c] Includes receipts from the sale of forest and maple products, dairy supplementary payments, deficiency payments, provincial stabilization payments, and other supplementary payments.

are more than twice as large as their Canadian counterparts and their labor productivity is reported to be lower than in Canada (Lanoie, 1985). Clearly, this puts more pressure on raw materials to be competitively priced at the farm gate than would be the case if the Canadian food and beverage manufacturing sector was more competitive in its own right, and in fact Gifford observed that "close to 70 percent of Canadian agricultural production is priced on an international basis."

For Canadian agriculture the large proportion of total production that is exported means producers face a more elastic demand. Deficiency payments are therefore a less efficient means of transferring income to producers because part of the benefits are transmitted to foreign buyers. In cases where foreign buyers also restrict imports, it may make more economic sense for exporters such as Canada to restrict supplies as a means of transferring income to producers.

### Market Structure

The economic geography of Canada--a small population in a ribbon-like configuration along the U.S. border--has an impact on market structure. Even with plant sizes averaging less than half of those in the United States, the Canadian food processing sector is less competitive than that of its southern neighbor. This is illustrated by comparing national concentration ratios: the weighted average $CR_4$ for the food and beverage manufacturing industry has been calculated at 52 in Canada versus 20-26 in the United States (Lanoie, 1985).[1]

Market concentration will be even higher than average in certain sectors and in practically all cases at the regional level, where it matters most in terms of describing the local market into which farmers sell their products. A potential benefit of freer trade with the United States might be to create a more competitive environment in the Canadian processing industry. In the meantime, however, this relatively less competitive environment has given the objective of equity among producers a higher status in Canada than in U.S. policymaking. This is one of the cornerstones and driving forces behind the Canadian Wheat Board and other marketing boards or agencies whose purpose includes the enhancement of bargaining power of producers. This condition and its consequences will not change quickly.

Another consequence of an imperfect market structure is that models that compare actual prices and quantities with those simulated for a perfectly competitive market may yield misleading results where the perfect market is not a realistic alternative. Given the structure of the Canadian agri-food industry, there may be little reason to believe that consumers would benefit from the dismantling of programs such as supply management to the extent inferred by much of the analysis of these programs to date.

### Political System

One of the driving forces behind agricultural policy in Canada is the natural rivalry created by shared jurisdiction between federal and provincial governments. Combined with the electoral system such that there could be at least one important election going on every year, and the party system where the federal party in power becomes a target to be embarrassed by the generosity of provincial parties of a different political persuasion, this situation provides an ideal environment for effective political lobbying or rent-seeking activities.

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[1] $CR_4$ (concentration ratio) refers to the aggregate market share (percent of total shipments) of the four largest firms in the industry.

The exploitation and results of this rivalry have only begun to appear within the past decade as some provincial governments indicated their willingness to enter the competition by funding a variety of income stabilization programs and "sweetening the pot" of production subsidies. Similarly, the farming community in Canada has begun to exploit this rivalry by sharpening their focus through commodity groups. Meanwhile, having experienced the financial burden associated with policy competition, the provinces are now beginning to show more interest in national solutions and harmonization of agricultural policies.

Barring unforeseen constitutional developments, however, the system will always remain decentralized in Canada where each province has jurisdiction over production and marketing within its own boundaries, leaving interprovincial and international trade to the federal government. Major policy developments and changes will likely continue to require a consultative process with agreement by a significant share of the provinces before the federal government will be ready to proceed. Diverging regional interests will continue to render the process of finding a national consensus on particular policy issues very difficult. Freer trade is no exception.

## Agricultural Interest Groups

The nature and activities of farm organizations have been evolving in Canada. The previous major crisis in agriculture in the 1960s gave rise to intensified competition between the more traditional Canadian Federation of Agriculture and the more radical National Farmers Union. While they did not disagree on all issues, the competition over who spoke for the farm community diluted the political impact of both groups during this period.

Since that time, the strength and effectiveness of both organizations as driving forces in agricultural policy has diminished considerably, being replaced to some extent by commodity groups with a more focused interest. As one subset of the commodity groups, marketing boards, especially at the national level, also have stronger financial resources to carry out lobbying activities.

One exception to the trend of declining strength of general farm organizations is found in the Province of Quebec. Here the Union des Producteurs Agricoles du Quebec has been authorized by the provincial government to represent the farm sector and, therefore, to require all bona fide farmers to become members. By strength of numbers and the absence of any other effective organization with the province, UPA is able to exert considerable influence as a driving force at the provincial level. Its means of generating revenues through compulsory membership and through some of its operational activities also give it financial strength unique among farm organizations.

Farm organizations are active in all other provinces, as well, although on a less comprehensive basis than the UPA. In all cases, even in Quebec, there has been a tendency to form ad hoc coalitions among various interest groups pooling their resources in a common front on major policy issues. This has not happened on the issue of free trade, but it did occur in both western and eastern Canada during the debate on the changes to the Crows Nest Pass Rate for grains.

There is a growing curiosity over how a political force as numerically unimportant as the farm population in industrialized countries can sustain the current level of public support for certain segments of the industry. In commenting on the durability and flexibility of domestic agricultural policies of industrial countries, Josling acknowledges that durability is thought by some to be due to the "lobbying activity and political cohesion" of the farming community and the vested interest of the bureaucracy, but he suggests that "the continuity of such programs may be attributed to the fact that they have fulfilled a need" (Josling, 1979, p. 150).

Little is known about the level of lobbying or rent-seeking activity of agricultural interests in Canada. Until recently, at least, the "fulfillment of need" argument of Josling likely explains most of the creation and maintenance of agricultural policy. But policies that have created benefits for particular interest groups may be expected to be vigorously defended when threatened with elimination or even modification.

In terms of effective political organization, Gardner found that the optimal number of farmers ranged from 25,000 to 150,000 and that it helped if they were regionally concentrated. These conditions are generally met for specific commodity groups in Canada.

## INSTRUMENTS

Broadly speaking, the policy instruments used in Canada may be classified into two main categories:

(a) Those involving budgetary allocation and expenditure for services and direct transfer payments

(b) Those involving regulations, marketing rules, and agreements (grades and standards, supply management, and marketing boards).

These are summarized below.

### Direct Expenditure

Although certain indirect expenditures such as taxation policy may at times have an influence on investment decisions, these policy instruments are generally of little importance in the context of Canada-U.S. trade in agriculture. The instruments that involve budgetary allocation and expenditure for services and direct transfer payments are of greater importance.

The amount and distribution among programs of federal and provincial expenditures in the agri-food sector for the periods 1980-82 and 1985-87 are shown in table 2. Of the direct expenditures, which averaged Can$4.7 billion in 1985-87, the most important instrument at the present time is transportation subsidies. These are financed primarily by the federal government and account for 21.5 percent of combined federal-provincial direct expenditure in agriculture. This is also the area in which the largest absolute and relative growth has occurred since 1980, reflecting the implementation of the Western Grain Transportation Act (WGTA) during that period. Although Feed Freight Assistance, Atlantic Region Freight Assistance, and a number of other transportation and storage programs are included here, the vast majority is attributable to the WGTA and other programs pertaining to the movement of western grain.

The second most important type of instrument for direct expenditures is a group of programs identified as production assistance (such as extension services) and financed largely by provincial governments. These have declined in relative importance since the early 1980s and now account for less than 20 percent of direct government expenditure in the agri-food sector.

Stabilization programs, financed by both levels of government, rank as the third most important instrument in terms of direct expenditures, although they too have declined in

TABLE 2. Distribution of Total Direct Expenditures, Federal and Provincial, in the Agri-Food Sector, 1980-82 and 1985-87

| | Annual average amounts (Can$ millions) | | Distribution: share of total direct expenditure (percent) | |
|---|---|---|---|---|
| Program | 1980-82 | 1985-87 | 1980-82 | 1985-87 |
| Farm credit | 171.2 | 393.6 | 5.6 | 8.4 |
| Production assistance[a] | 638.6 | 865.1 | 21.0 | 18.4 |
| Stabilization | 611.4 | 656.9 | 20.1 | 14.0 |
| Crop insurance | 140.0 | 261.7 | 4.6 | 5.6 |
| Transportation | 423.3 | 1,007.5 | 13.9 | 21.5 |
| Marketing | 294.4 | 397.8 | 9.7 | 8.5 |
| Federal-provincial agreements | 115.3 | 191.3 | 3.8 | 4.1 |
| Research | 185.4 | 335.3 | 6.1 | 7.1 |
| Others | 457.4 | 581.9 | 15.1 | 12.4 |
| Total | 3,037.1 | 4,691.1 | 100.0 | 100.0 |

*Source:* Unpublished data from Agriculture Canada, Policy Coordination Branch.

[a] Includes resource conservation measures.

importance since the early 1980s. They presently account for about 14 percent of total direct expenditures in the agri-food sector compared to 20 percent in the 1980-1982 period.

As these stabilization programs have evolved, the progression has been toward cost sharing with producer contribution or subscription fees levied, usually on a formula of two dollars of public money for each one from producers. In joint federal-provincial schemes such as that for red meats, the public contribution is shared equally by both levels of government leading to the title "tri-partite stabilization."

The most significant federal or joint programs in this category are the Agricultural Stabilization Act of 1975 (which covers cattle, hogs, sheep, industrial milk, corn, and soybeans) and the Western Grains Stabilization Act of 1976. In pointing out the differences between Canadian and U.S. programs of this type, Barichello states:

> In Canada, there are few offer-to-purchase price supports, no supply limitations or acreage restrictions outside the supply management-marketing boards, no privately-held grain reserve policies and a relatively small use of private stabilizing tools. Instead, Canada has focussed its policy efforts on subsidized, stop-loss, insurance-type stabilization programs which attempt to operate without interfering with the effects of long term market forces, and which are still being developed and modified (Barichello, 1986, p. 28).

In terms of commodity coverage, federal direct expenditures have been allocated among the major commodity groups to the extent possible (Rodier, 1985). The proportions of these expenditures are illustrated in figure 2 in relation to the share of farm cash receipts accounted for by each commodity group. If one considers farm cash receipts an indicator of economic importance which, in turn, may be considered as one factor explaining public support, points along the diagonal in figure 2 would represent a "fair share" of public support. The area to the right of the diagonal represents a disproportionately large share of federal expenditure in relation to this measure of economic importance. Points to the left of the diagonal represent a disproportionately small share.

According to this analysis, there does not appear to be a high correlation between economic importance (as measured by farm cash receipts) and direct federal expenditures by commodity group in 1980-82. The sectors closest to the "fair share" line were dairy and fruits with grains receiving a disproportionately large share of public expenditure (even prior to WGTA) and most livestock a very small share. At the extreme, beef accounted for 19 percent of farm cash receipts but received only 2 percent of direct federal expenditure.

In fairness to the grains sector, when contribution to exports is included as a measure of economic importance, the distribution of support appears more even. As shown in table 3, grains and oilseeds accounted for 73 percent of agricultural exports, 34 percent of farm cash receipts, and 46 percent of direct federal expenditures. In general, however, with the exception of the dairy sector, which, along with poultry, also enjoys the benefits of supply management, public support for crops (especially grains) has been proportionately much higher than for livestock production relative to economic importance of those broad sectors.

Commodity coverage of other policy instruments as described by Warley are presented in table 4. As illustrated here, virtually all farm-gate commodities are subject to some measure of price support, and many receive one or more forms of trade protection. Grains produced in western Canada are marketed by the Canadian Wheat Board and are eligible for stabilization support, transport subsidies, crop insurance, and import protection which

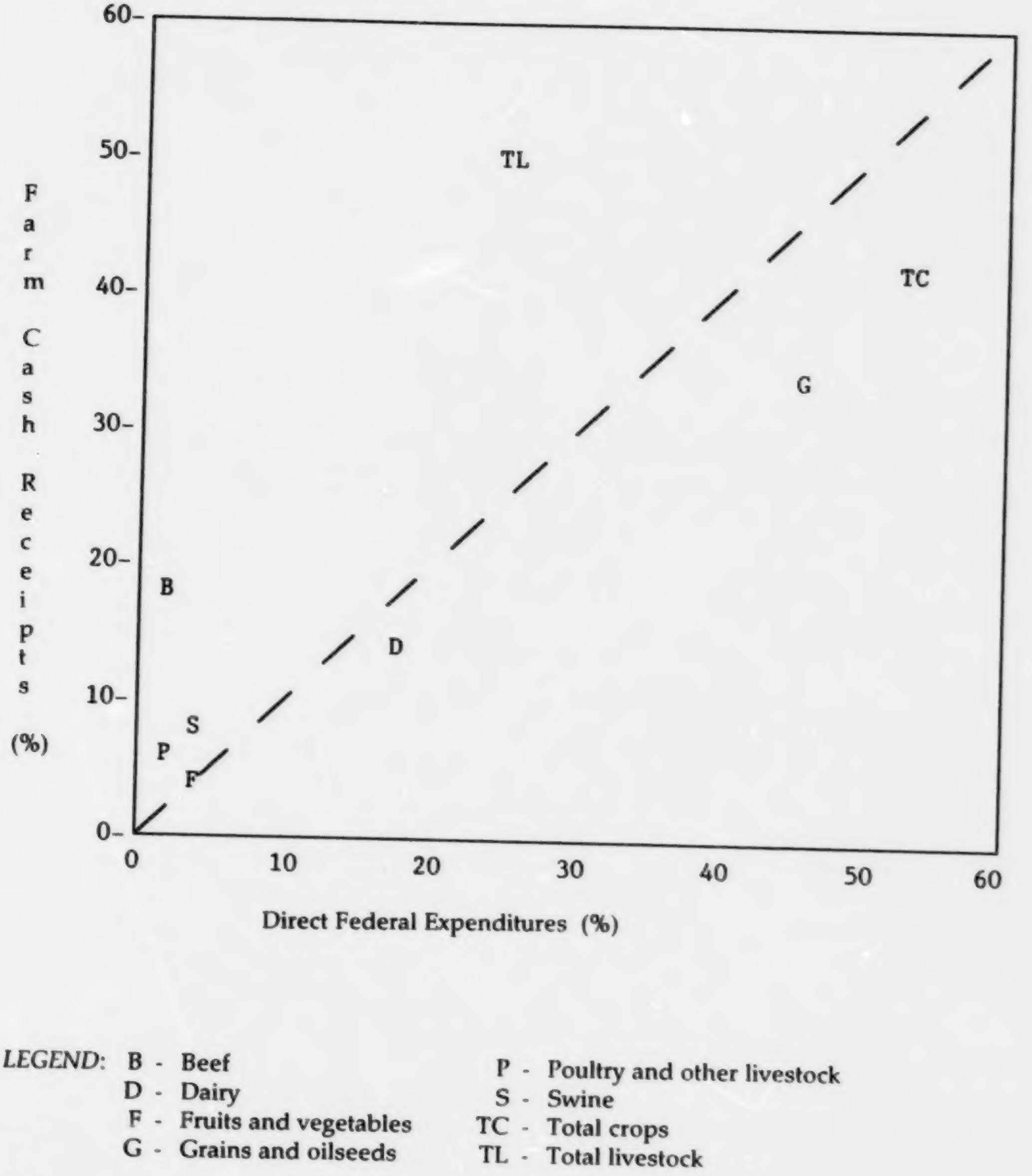

FIGURE 2. Distribution of farm cash receipts and direct federal expenditures by commodity group in Canada, 1980-82. *Source:* Data in tables 1 and 3 of this paper.

TABLE 3. Distribution of Farm Cash Receipts, Exports, and Direct Federal Expenditures by Commodity Group in Canada, 1980-82

(in percent)

| | Farm cash receipts | Agricultural exports | Direct federal expenditure |
|---|---|---|---|
| Dairy | 15 | 4 | 17 |
| Beef | 19 | 4 | 2 |
| Swine | 9 | 5 | 4 |
| Poultry and other livestock | 7 | 2 | 2 |
| Subtotal | 50 | 15 | 26 |
| Grains and oilseeds | 34 | 73 | 46 |
| Fruits and vegetables | 5 | 4 | 4 |
| Other crops | 3 | 2 | 3 |
| Subtotal | 42 | 79 | 53 |
| Unallocatable | 8 | 6 | 21 |
| Total | 100 | 100 | 100 |
| Grand total ($ millions) | 17,786 | 8,624 | 2,068 |

*Sources:* Data from (a) Agriculture Canada, *Handbook of Selected Agricultural Statistics*, 1986, Ottawa; (b) M. Rodier, "Federal Government Expenditures in the Agrifood Industry 1970-1971 to 1982-1983," *Canadian Farm Economics* vol. 19, no. 1, pp. 33-45 (Agriculture Canada, 1985).

TABLE 4. Major Commodity-Specific Policy Instruments Affecting Output, Consumption, and Trade, Canada, 1984

| | Wheat | Barley | Corn | Soybeans | Canola products | Cattle | Hogs | Beef and veal | Pork | Sheepmeat | Chicken | Turkey | Eggs | Fluid milk | Industrial milk | Butter | Cheese | Powdered milk | Sugar | Potatoes | Fruits and vegetables | Tobacco | Grapes/Wine |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Product Support** | | | | | | | | | | | | | | | | | | | | | | | |
| Price & margin support | | | | | | | | | | | | | | | | | | | | | | | |
| Full cost pricing | | | | | | | | | | | ★ | ★ | ★ | ★ | ★ | | | | | | | | |
| Floor pricing | ★ | ★ | ★ | ★ | ★ | ★ | ★ | | | ★ | | | | | | | | | ★ | ★ | ★ | ★ | |
| Margin support | ★ | ★ | | | ★ | | | | | | | | | | | | | | | | | | |
| Two prices | ★ | | | | | | | | | | | | | | | | | | | | | | |
| Supply control | | | | | | | | | | | ★ | ★ | ★ | ★ | ★ | | | | | | | ★ | |
| Trade controls | | | | | | | | | | | | | | | | | | | | | | | |
| Tariffs | ★ | ★ | ★ | | | | ★ | ★ | ★ | ★ | ★ | ★ | ★ | | | ★ | ★ | ★ | ★ | ★ | ★ | ★ | |
| Quotas | | | | | | | | ★ | | | ★ | ★ | ★ | | | ★ | ★ | | | | | | |
| Licensing | ★ | ★ | | | | | | ★ | | | ★ | ★ | ★ | ★ | | ★ | ★ | ★ | | | | | |
| State trading | ★ | ★ | | | | | | | | | | | | | | ★ | | ★ | | | | | ★ |
| Export subsidies | | | | | | | | | | | | | | | | | | ★ | | | | | |
| Food aid | ★ | | | | | | | | | | | | | | | | | ★ | | | | | |
| **Input subsidies** | | | | | | | | | | | | | | | | | | | | | | | |
| Transport | ★ | ★ | | | ★ | | | | | | | | | | | | | | | | | | |
| Storage | | | | | | | | | | | | | | | | | | | | ★ | ★ | | |
| Crop insurance | ★ | ★ | ★ | ★ | ★ | | | | | | | | | | | | | | | ★ | ★ | ★ | ★ |

*Source:* Reprinted, with permission, from T. K. Warley, "Canada's Agricultural and Food Trade Policies," in D. Gale Johnson, Kenzo Hemmi, and Pierre Lardinois, eds., *Agricultural Policy and Trade: Adjusting Domestic Programs in an International Framework,* A Task Force Report to the Trilateral Commission (New York University Press, 1985), p. 92.

permits the domestic price for wheat to be maintained above the export price. Oilseeds and cereals grown in eastern Canada are eligible for crop insurance and stabilization payments, as are fruit, vegetables, and potatoes. Cattle and hogs are eligible for federal and, in some cases, provincial stabilization programs. But the most comprehensive instruments are those that combine administered pricing with production and import controls as applied to dairy and poultry products. These belong in the category of marketing rules and institutions, to which we now turn.

### Supply Management

There are many ways in which governments are involved in the marketing of farm products. Some of these, such as the setting and administration of standards through grading and inspection services and the provision of market information, are widespread and beneficial to both producer and consumer in improving market efficiency and ensuring product quality. These mechanisms can, however, also be used as trade barriers and are subject to the current negotiations.

Supply management marketing boards have attracted attention. Canada has a long experience with marketing boards, with more than 100 operating in a broad range of commodities (Schmitz, 1983). In most cases the powers exercised are modest and nonrestrictive. Examples of these activities include promotion, information, price negotiation, and pooling. Many such boards operate as little more than commodity groups or associations.

National supply management schemes did not come into being until the 1970s and even now apply only to dairy, poultry, and eggs and represent between 20 and 25 percent of farm cash receipts. In these cases, production quotas are combined with administered pricing and import controls to maintain prices generally in excess of those prevailing in the United States.

Contrary to some impressions, the supply management systems are not permitted to run as unconstrained monopolies. Rather, they are charged with ensuring adequate supplies to the domestic market, either through production or imports, with prices usually tied, in some manner, to costs of production or established by committee. The activities of these boards or agencies are supervised federally by the National Farm Products Marketing Council and by provincial supervisory bodies. These conditions reflect a measure of consumer protection as well as benefits to producers.

Despite these safeguards, supply management programs have been criticized for causing large income transfers from consumers to producers as well as for the ultimate cost implications of the capitalization of those benefits into the price of transferable production quotas (Barichello, 1986; Schmitz, 1983). While the case against supply management has often been overstated, the problems posed by quota values must be addressed through more flexible pricing arrangements or by some other means.

Insofar as trade is concerned, however, supply management systems do not contribute to unmarketable surpluses and have only minimal trade-distorting effects, at least for poultry products. As expressed by Warley, "The pricing, production, and trade arrangements for eggs and poultry meats probably have no adverse effects on foreign suppliers and so, while they are of great concern to Canadians, they do not constitute a trade policy issue between Canada and her trading partners" (p. 91).

Dairy products represent a more complex case in that a subsidy amounting to some Can$300 million is still paid directly to producers of industrial milk within the supply-managed system. In this instance, production of butter to meet domestic requirements results in a surplus of skim milk powder, which must be exported at a loss financed by a levy on producer returns. Quotas and tariffs are used to restrict imports.

Canadian support for the concept of supply management, at least where it presently exists, appears strong and will continue to be defended vigorously by those most directly affected. This includes governments who recognize the benefits of being able to stabilize producer income without budgetary implications. It also includes producer groups who would face large capital losses (quota value) as well as destabilized income prospects and would need to be compensated if the system were substantially changed.

In a world of imperfect markets with a tendency to overproduce for effective demand, responsible management of resources is required to prevent overinvestment in nonviable activities. In this context the concept of supply management has economic merit, even at the international level. The challenge is to find a pricing mechanism that takes due account of both supply and demand, including productivity increases, so as not to contribute to excessive income transfers.

There are numerous other policy instruments applied by the federal or provincial governments in Canada, as there are in the United States. These include credit programs, input subsidies, research, information, and extension services, among others. There may be an aggregate effect on agricultural trade from the application of these instruments, but individually they are of minor importance.

## INSTITUTIONS

Agri-food policy is relatively decentralized in Canada in terms of the institutions responsible for development and implementation. The provincial governments now account for 40 percent of total direct public expenditures in the agri-food sector. Even at the federal level, involvement is spread across up to a dozen departments with Agriculture Canada responsible for only 45 percent of the federal share of direct expenditures by government (Rodier, 1985).

The shared jurisdiction between federal and provincial governments, which can be a major obstacle to domestic as well as international policy harmonization, has its roots in section 95 of the Constitution Act of 1867, commonly known as the British North America Act (Bailey, 1986). But the sharing has been reinforced by convention and consultation, by the actions of provincial governments, and by federal-provincial agreement. Although it does not have legal status, a report signed by all eleven ministers of agriculture in Canada last year stipulates six principles of national agricultural strategy. Among the principles the "full recognition of the sharing of jurisdiction" and "effective cooperation among governments" are the first and last, and others include government action that is "equitable and sensitive to regional economies," market orientation, competitiveness, importance of the private sector, and support for the family farm (*National Agriculture Strategy*, 1986).

It has long been understood that the provincial governments hold authority over production and marketing of agricultural products within their own boundaries with the federal government having jurisdiction over the interprovincial and international trade. In reality, there is a tendency to overlap to some degree, which is reaffirmed in *A National Agriculture Strategy* referred to above. One of the principles for action contained in the report, giving substance to the recognition of shared jurisdiction and responsibility, is that both levels of government have the right to intervene in the areas of finance, marketing, research, production assistance, and income stabilization. Within the past decade or so there has been a tendency to move toward jointly funded federal-provincial programs, especially in the areas of marketing, income stabilization, crop insurance, and regional development (Grant, 1986).

Perhaps the most significant and complex area of federal-provincial agreement is that pertaining to the operation of national or regional supply management systems. In this case, the shared jurisdiction over marketing required coordinated legislation at both levels of government whereby the provinces assign certain powers to the federal authority, with protection of those rights ensured by all parties remaining as signatories to a complex agreement procedure concerning changes in the operation of the system. The requirement for provincial agreement is one reason that supply management systems are unlikely to be dismantled through the current bilateral negotiations.

Shared jurisdiction over agriculture may lead to conflict between or among provinces as well as between the two levels of government. One of the roles of the federal government is to resolve interprovincial trade disputes (Bailey, 1986). Indeed, it might be argued that the primary reason that we have supply management in the poultry sector today is the so-called "chicken and egg war" between Quebec and Ontario in 1970-71, which forced the federal government to adopt legislation facilitating creation of regional or national marketing boards with powers of pricing and supply management.

The jurisdiction and involvement pattern of federal and provincial governments in agri-food policy is revealed, in part, by the allocation of direct spending at each level among the major program categories. These are summarized in table 5 along with an indication of the growth in each category since 1980-82. At the federal level, transportation subsidies have replaced stabilization programs as the leading category of expenditure, reflecting the impact of the Western Grain Transportation Act. Provincially, production assistance programs such as extension services remain the most important, although credit and stabilization programs have gained ground since 1980-82.

The importance of the WGTA is shown in table 6, which illustrates the distribution of federal agri-food expenditures among major departments. In the decade between 1972-73 and 1982-83, Transport Canada, which administers the WGTA, grew from accounting for only 5.2 percent of federal expenditure to become second in importance (at 27.3 percent) to Agriculture Canada (44.2 percent).

In addition to department involvement, both levels of government (federal and provincial) have created a number of boards and commissions to implement certain programs. Best known among these at the federal level are the Canadian Wheat Board, Canadian Grain Commission, Canadian Dairy Commission, Livestock Feed Board of Canada, Western Grain Transportation Authority, Agricultural Stabilization Board, and National Farm Products Marketing Council. While the task of these organizations is primarily the execution of policies and programs, they may, at times, become involved in the policy process.

For commodities under supply management (milk, eggs, chicken, and turkey) there exist a network of provincial marketing boards and a national marketing agency in each case. Although these agencies are sanctioned by federal and provincial legislation and supervised by government bodies, they are essentially producer organizations, created to administer the supply management systems and, in the case of poultry and eggs, funded by a levy on the product for which they are responsible.

There are numerous other marketing boards, commodity groups and farm organizations which may be involved in lobbying, helping to develop policy on a consultative basis, administering programs on a contractual arrangement (advance payments), or engaged in some measure of marketing activities such as single-desk selling, price discovery, information, promotion, and other services. None of these represents a major institutional feature in the context of the freer trade challenges.

## SUMMARY AND CONCLUSIONS

Policy instruments and the institutions that apply them are shaped by a variety of driving forces including social values and beliefs, the nature of the problems and objectives, importance to the national economy and international exposure of agriculture, systems of

TABLE 5. Distribution of Average Annual Federal and Provincial Expenditures in the Agri-Food Sector by Function, 1985-87, with Comparisons for 1980-82

| | Amounts ($ millions) | | Distribution (percent) | | Growth (percent of 1980-82) | |
|---|---|---|---|---|---|---|
| Function | Federal | Provincial | Federal | Provincial | Federal | Provincial |
| Farm credit | 30.0 | 363.6 | 1.0 | 20.9 | 184 | 235 |
| Production assistance[a] | 60.8 | 804.3 | 2.1 | 46.3 | 87 | 141 |
| Stabilization | 471.3 | 185.6 | 16.0 | 10.7 | 87 | 264 |
| Crop insurance | 205.2 | 56.5 | 6.9 | 3.3 | 187 | 187 |
| Transportation | 1,006.1 | 1.4 | 34.1 | -- | 258 | 4 |
| Marketing | 280.0 | 117.8 | 9.5 | 6.8 | 133 | 141 |
| Federal-provincial agreements | 191.3 | -- | 6.5 | -- | 166 | -- |
| Research | 243.4 | 91.9 | 8.2 | 5.3 | 200 | 144 |
| Other | 465.0 | 116.9 | 15.7 | 6.7 | 120 | 164 |
| Totals | 2,952.7 | 1,737.3 | 100.0 | 100.0 | | |

*Source:* Unpublished data from Agriculture Canada, Policy Coordination Branch.

[a] Includes extension work, resource conservation programs, soil testing services, etc.

TABLE 6. Distribution of Agri-Food Expenditures by Federal Government Departments, Selected Years

(in percent)

| Department | 1972-73 | 1977-78 | 1982-83 |
|---|---|---|---|
| Agriculture Canada | 46.8 | 57.5 | 44.2 |
| External Affairs | 15.1 | 15.7 | 13.4 |
| Industry - Commerce | 21.4 | 6.7 | 6.6 |
| Regional Economic Expansion | 9.5 | 6.4 | 3.6 |
| Transport | 5.2 | 10.7 | 27.3 |
| Employment and Immigration | -- | 1.0 | 1.9 |
| Other[a] | 2.0 | 2.0 | 3.0 |
| Total (percent) | 100.0 | 100.0 | 100.0 |
| ($ millions) | 668.8 | 1,668.4 | 2,283.0 |

*Source:* Based on data from M. Rodier, "Federal Government Expenditures in the Agri-Food Industry 1970-71 to 1982-83," *Canadian Farm Economics* vol. 19, no. 1, pp. 33-45 (1985).

[a] Includes Indian and Northern Affairs, Environment, Health and Welfare, Science and Technology, and Supply and Services.

government, market structures, and economic environment. There are important differences as well as similarities between Canada and the United States in many of these. Among the differences, for example, Canadian agriculture is more highly integrated into the international market and simultaneously faces a greater concentration of market power and foreign ownership in the domestic market than is the case in the United States.

Considering the influence of the driving forces behind agricultural policy, and differences in these between the two countries, there is good reason to expect a higher level of intervention in Canadian agriculture. In fact, for the period 1982-84, the producer subsidy equivalents for all commodities were about the same in both countries, and Canada had lower support for wheat, corn, and sugar. Protection for dairy and poultry products, however, was higher in Canada.

The commodity coverage of national policies in Canada is broader than in the United States, especially in terms of stabilization programs for red meats and supply management for poultry products. This is generally consistent with the economic importance, trade position, and nature of supply and demand for these commodities.

The greater concentration of market power, regional distribution of production, and system of government in Canada elevate the importance of equity among producers as a policy objective. These conditions, along with budgetary considerations, favor more direct intervention in Canada such as through marketing boards and supply management. Economic geography and export market importance also favor greater emphasis on competitiveness and regional development and the use of instruments such as transportation subsidies.

The distribution of powers between federal and provincial governments and regional characteristics of agriculture has rendered difficult the process of policy harmonization within Canada. Policy harmonization with the United States, or any other country, will be even more difficult unless there are clear gains to be realized. Such gains are not yet evident for agriculture in the case of freer trade between Canada and the United States, making this one of the more difficult challenges of any free trade agreement.

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# U.S.-CANADIAN TRADE LIBERALIZATION: KEY ISSUES

**Bob H. Robinson, Mary Anne Normile, Carol A. Goodloe, and Robert M. House**

## INTRODUCTION

In the world's largest bilateral trading relationship, Canada, the smaller economy, is more dependent on the U.S. market for its exports and imports. Although the United States has greater market penetration into Canada, it has also been a rather loud complainer lately, as its exports to Canada have slipped and Canadian shipments across the border have mounted. Trade disputes between the two nations have recently become commonplace and have generated heated debates on trade distortions and formal negotiations on liberalization of trade. Many commodities have become the target of trade disputes. The variety of commodities affected--onions, potatoes, hogs, sugar blends, winter vegetables, raspberries, wine, corn, cattle, and forestry and fish products--is unique because of the geographic proximity, long border, and relatively free trade between the countries.

Both countries have policies and programs interdicting free trade. These subsidies stand as barriers to trade. Breaking down such barriers may be an impossible task because of overriding national concerns such as maintaining price and income stability, assuring an adequate and secure food supply, and preserving the family farm or some desired farm structure. And, of course, the need to preserve domestic policy sovereignty is pervasive. Yet, harmonization of policies--coordinating U.S. and Canadian domestic and trade policies to improve market access--could go a long way toward liberalizing trade between the two countries.

U.S. agricultural exports to Canada represent a significant share of Canadian consumption for some commodities: fruits and vegetables, rice, cotton, soybeans, and soybean products. During parts of the year, the United States supplies 100 percent of Canadian consumption of fruits and vegetables. Over half of Canada's agricultural imports come from the United States.

U.S. imports generally account for only a small share of U.S. consumption. But within this share, Canada is a major supplier of live animals, wheat and coarse grains, flaxseed, carrots, potatoes, and field and garden seeds. Canada has no commodity penetration in the U.S. market comparable to the U.S. penetration of the Canadian fruits and vegetables market. But as the United States buys about 25 percent of Canada's agricultural exports it is a very important market for Canada. Freer trade would aid Canada much more because of the greater potential market offered by the United States. Traditional trade theory gives us an idea of some of the benefits and costs that each country may realize.

## BENEFITS AND COSTS OF LIBERALIZING TRADE

How much can two countries benefit from liberalizing trade? Standard analysis of the gains from trade describes what happens when an economy moves from self-sufficiency and nonreliance on imports to free trade.

## Gains From Trade

Free trade is superior to autarky (self-sufficiency), according to traditional economic theory (Coyle, Chambers, and Schmitz, 1986). Differences in technology, resource endowments, climate, and quantity of capital available will result in different pre-trade prices between the two countries. Where price differences exist, both countries can gain by trading. Consumers gain when lower trade barriers allow them access to goods otherwise unavailable or more expensive in the domestic market. Consumer prices fall and demand climbs as trade barriers are eliminated.

One significant effect of free trade is that the producing sector gains through specialization, which leads to increased efficiency as each country produces more of its lower-cost good, exports its lower-cost product, and imports goods that can be made more cheaply abroad than in the domestic market. Resources are reallocated from less productive to more productive uses. Changes in consumption, production, and trade that result from price changes in both the importing and exporting countries are direct effects.

The gains from specialization are not confined to production activities. Specialization also allows each country to concentrate efficiently research and development resources, develop new varieties or breeds, and achieve advances in agricultural technology focused on a smaller number of agricultural products. Marketing and transportation specialization could produce an improved, more highly developed marketing network for fewer products. Shipping fewer products in greater volume would allow greater use of volume discounts and unit trains. For example, moving fewer kinds of grain in larger lots can lead to more efficient use of elevator and terminal facilities. Longer-term welfare gains include increased competition in the importing country from foreign suppliers leading to efficiency gains as producers try to reduce costs to meet competition, technological change as increased trade stimulates research and development in the exporting country, investment as countries expand production of the good in which they have comparative advantage and as industries modernize to meet competition, and expansion to meet growing trade allowing industry to increase production and reduce unit costs as it exploits economies of scale.

Some short-run adjustment costs may, however, be incurred in the shift to a freer trade environment. In a frictionless world, factors move with relative ease from the declining sector to the expanding sector. In the real world, reducing the level of protection afforded a sector causes costs and dislocations. These dislocations may persist if resources cannot be readily transferred among production sectors. Reducing protection may exacerbate a short-run balance of payments surplus or deficit and may cause unemployment or idle capacity. Political pressure for relief can be great when these unemployed factors are concentrated in a few regions or industries.

Gains from a bilateral agreement that results in a free trade area may be limited, depending upon the interaction of two trade effects: trade creation and trade diversion. Trade creation is the result of the increased consumption in response to the lower price and as domestic production in the higher-tariff country is replaced by imports from the other country. Trade diversion occurs as trade increases between the member countries as barriers are lowered between them but left in place for the rest of the world. Trade creation increases welfare, but trade diversion reduces it because it transfers production from a lower-cost producer to a higher-cost producer. The welfare gains from establishing a free trade area depend on the relative size of trade creation versus trade diversion. The static welfare gains from establishing a customs union or free trade area are small, on the order of 1 percent or less of national income, according to most studies.

### Historical Precedents

Among industrialized countries, preferential trading arrangements range from extensive bilateral tariff reductions to a common market. Nearly all existing preferential trading arrangements encountered difficulty when incorporating agricultural products into the initial agreement.

The European Economic Community (EC), representing the greatest degree of economic integration among developed market economies, was formed from a group of relatively small, price-taking countries of approximately equal economic size (Wonnacott and Wonnacott, 1967). These characteristics presented significant opportunities for exploitation of scale economies and specialization.

Agricultural products were accorded special treatment in the 1985 U.S.-Israeli free trade agreement. Israel is a very small country whose exports are generally complementary to U.S. agricultural exports (Avidor, 1985). Therefore, specialization of production is already fairly complete. Tariff reduction for certain "sensitive" agricultural products likely to compete with domestic products was deferred until the ten-year target date.

The 1983 Australia-New Zealand Closer Economic Relationship Trade Agreement (CER) built on earlier agreements that led to a limited free trade area. Under the CER, New Zealand's exports to Australia have grown by an average 31 percent per year, while Australia's exports to New Zealand have increased by an average of 18 percent per year. New Zealand's greater prosperity after liberalizing trade with Australia provides support for a basic tenet of trade theory that the smaller country gains more from freer trade. Because agriculture proved to be a sticking point for the agreement, there were many exemptions for agricultural products and deferred timing of phased tariff reductions on agricultural goods.

## THE U.S.-CANADA CASE

The greater the similarity between two economies, the greater is the potential gain from specialization and trade. Dissimilar economies are already specialized vis-à-vis one another. Canada is already a little more specialized in agricultural production than the United States, producing fewer varieties of agricultural products and tending to concentrate in cereals, oilseeds, and livestock products. The United States produces, in addition to these, a wide variety of fruits, nuts, vegetables, and products which require longer growing seasons or a Mediterranean or subtropical climate. Further specialization of production might involve the United States shipping more fruits and vegetables to Canada, with Canada expanding its U.S.-bound livestock exports. There are, however, many similarities between the two economies.

The United States and Canada both produce large quantities of grains and oilseeds, livestock, meat, and dairy products, and both already engage in land-extensive, large-scale crop production. Therefore, opportunities for further exploitation of scale economies in field crop production may be limited. But untapped economies of scale may yet remain in the grains and oilseeds handling and processing industries. Opportunities for specialization and the possibility of gains from exploiting economies of scale may also exist in the livestock complex, particularly poultry production, where Canadian marketing boards have inhibited a move to large-scale production and vertical integration.

Relative levels of protection will affect who gains most from freer trade, and will determine which country is more likely to face serious adjustments from a more open economy. Gains from tariff removal alone are likely to be quite small since tariffs on much of the two-nation agricultural trade are already fairly low. Canadian agricultural producers may suffer greater short-run dislocations from free trade since their agricultural sector is more highly protected by tariffs and nontariff barriers. For some products in both countries, freer trade could reinforce a long-term trend toward increasing farm size and may accelerate replacement of uneconomic production units by production units of a more economic size or structure. There would be dislocation costs associated with these changes also, but there would also be a greater potential for long-run efficiency gains.

Theoretical gains from increased trade rest on highly restrictive assumptions, including a "frictionless" world where transport costs do not affect trade patterns. In reality, transportation costs do have a unique effect on North American trade patterns, since transport costs between remote points within each country in some cases may be higher than costs of moving goods shorter distances between countries. Many adjacent regions in the two countries are already more closely integrated than distant regions in the same country (Wonnacott and Wonnacott, 1967). Therefore, analyses of comparative advantage based on relative costs of production may be misleading in the U.S.-Canada case.

The United States and Canada already have the greatest volume of bilateral trade of any two countries and a relatively open border produces a significant volume of border trade. A trade union of the two would consist of one very large country within which there may be few opportunities to realize efficiency gains by expansion of market, and one considerably smaller country where there is significant opportunity for realizing efficiencies of production. According to theory, and the Australia-New Zealand example supports it, a small country has potentially more to gain from free trade than the large country. Canada would thus likely benefit more from freer trade. Some parts of Canada's agricultural sector could expand their markets as much as ten times. The potential for U.S. expansion is much smaller. Efficiency gains are also likely to be greater for Canada. Many elements of the U.S. agricultural sector are already highly efficient because of the size of the U.S. market. Hence, a 10 percent increase in the current market would not lead to significantly increased operational efficiency.

## Empirical Evidence

A number of recent studies have attempted to measure the gains that would come from liberalizing trade between the United States and Canada. The studies vary according to the degree of trade liberalization assumed (selective tariff reduction, across-the-board tariff removal, quota removal, liberalization of government restrictions on procurement), the level of sectoral detail, and the complexity of the methodology used to produce the results. Most focus principally on the industrial sector, but a few incorporate results for agriculture.

Most of the studies conclude that the overall gains are likely to be quite small. The exception is a study by Cox and Harris (cited in Harris), in which it was estimated that mutual elimination of tariffs and nontariff barriers in all industrial sectors would increase Canadian gross national expenditure by 9 percent. Brown and Stern showed a decline in Canadian gross national product (GNP) of 0.35 percent and an increase in U.S. GNP of 0.03 percent. The Economic Council of Canada estimated that removing trade barriers would increase real GNP in Canada by 1.5 percent by 1995 (over the base case level which assumed no change in trade policy). Dixit and Roningen found that removing border measures on all bilateral trade, including manufacturing and other traded goods as well as agriculture, increased GNP in both countries by less than 1 percent. Changes in GNP cited by these studies are relative to the current situation and generally based on analysis of the removal of selected trade barriers. The alternative to freer trade, however, may not be the status quo, but rather increased protectionism.

## Trade Distortions

As trade conditions between the United States and Canada clearly demonstrate, the real bilateral trading world is itself a significant distortion of the theoretical case for free trade. Each commodity involved in trade disputes represents a particular distortion to the theoretical case of free trade. To find an item on either side of the border without a tariff, quota, labeling requirement, or health regulation is virtually impossible. On the other hand, many of the restrictions are rarely significant impediments to trade. Thus arises the complex job of identifying those that significantly distort trade between the two partners and estimating by how much.

Tariffs on agricultural products are generally low, with little restriction to trade. Exchange rate movements over the past five to six years have more than offset the effects of many tariffs. Thus, nontariff barriers are more significant in distorting agricultural trade between the United States and Canada. (The paper by Prentice and Menzie in this volume contains a detailed discussion of nontariff barriers, including domestic production subsidies, health and inspection requirements, and various types of regional/commodity market control.)

Domestic policies that insulate a sector or industry from international competition generally use some mechanism to regulate prices or production and then close off the border to imports to maintain the integrity of the program. Familiar examples include the U.S. dairy and sugar programs and Canadian dairy and poultry programs.

Commodities that have been the center of U.S.-Canadian trade disputes have not always been those where border protection--that is, tariffs, quotas, licenses--has been most restrictive. Rather, complaints have tended to focus on domestic programs that effectively alter the production function, terms of trade, or comparative advantage for one country's commodity(ies) over the other's. For example, there have been no major disputes over dairy trade because both sides have effectively prohibited such trade. Disputes have arisen over corn and hogs because trade is relatively unhindered by restrictions and the products flow to the best return. Canadian transportation laws on such products as mill feeds, rapeseed oil and meal, and alfalfa also concern the United States.

The hog and corn countervailing duty cases show that practically any government program can be considered a subsidy. The United States determined that Canadian Federal and Provincial stabilization programs for hogs constituted subsidies, while Canadian officials determined that the U.S. feed grain program--commodity loans, deficiency payments, diversion payments, Commodity Credit Corporation (CCC) expenses--conferred subsidies upon producers.

Related to the subsidy question of "how much" and the effects of domestic subsidies on trade is the question of trade remedy laws; that is, anti-dumping and countervailing duty laws that both countries have on the books to provide protection from unfair import competition. U.S. commodity groups have resorted to legal trade remedies much more often in the 1980s than earlier to reduce the inflow of those goods they believe are unfairly produced or traded. Canadians see the increasing use of trade laws as harassment and many decisions as arbitrary.

The entire subsidy/countervailing duty issue is becoming more, not less, complex. Although both countries want a reduction in agricultural subsidies, negotiating such a reduction is in fact very difficult. Do subsidies mean all government programs? Or can we agree which subsidies seriously distort production and trade and which ones we can live with? Reducing subsidies bilaterally may prove impossible because such actions may provide advantages to third countries which can continue to subsidize and reap trade benefit from a bilateral reduction.

### Measures of Government Intervention

Which side offers more assistance to its producers? Although often asked in an accusatory manner, this question is actually very pertinent because the answer provides information on how trade would be affected if that assistance were removed. The USDA's Economic Research Service and others have shed light on this question by measuring the support accruing from government intervention in agriculture. The measures are termed producer and consumer subsidy equivalents (PSE and CSE) (U.S. Department of Agriculture, 1987). The papers by Blandford and Huff, in this volume, discuss these measures in more detail.

As both the bilateral and multilateral (GATT) trade negotiations proceed, transparency in the provision of assistance to agriculture has become an important issue. Negotiators, policymakers, producers, and consumers all need to know the sources of producer and consumer subsidies.

PSEs can be divided into two sources of support: that provided by the consumer through higher-than-world prices and that provided by the taxpayer through government budget outlays. Border measures raise consumer as well as producer prices and can be viewed as hidden subsidies to producers; in most developed economies, consumers must bear these costs. Increasing the transparency of such measures can help lead to better, more informed decisions that increase the general welfare.

## MACROECONOMIC ISSUES

The prevailing macroeconomic environment affects to a large extent the level and net direction of bilateral trade in agricultural products. Changes that could affect key macroeconomic variables could have a disproportionate effect on agricultural trade. The U.S.-Canadian exchange rate will continue to be a key issue in bilateral trade. For example, the Canadian dollar has experienced a long period of weakness relative to the U.S. dollar, and removal of trade barriers could result in even more Canadian products flowing into the United States. In addition, shifts in nonagricultural trade could likewise affect certain macroeconomic variables. Nonagricultural trade accounts for over 90 percent of U.S.-Canadian trade. Any sizeable shift in the nonagricultural balance of trade could produce exchange rate shifts that could swamp small tariff reductions for agricultural products.

Exchange rate imbalances can lead to trade disputes and problems of policy coordination. Exchange rates are traditionally considered the international price of a country's currency. Problems arise because it is difficult for one price to clear two markets simultaneously. The exchange rate represents, on the one hand, a price for traded goods. As such, it should produce equilibrium in the balance of trade. But the exchange rate is also the price of international capital, and problems arise because international capital markets are volatile and can produce shifts in the exchange rate unrelated to a country's underlying competitive position (Wonnacott, 1987). Misalignments in exchange rates can persist due to capital flows and the interest and dividend payments resulting from past capital flows.

Capital inflows may present a dilemma for policymakers:

- On the one hand, large capital inflows can provide a means for a country to build productive capacity and thereby increase its long-term competitive position.

- But large capital inflows contribute to a stronger currency, which could lead to a trade deficit and unemployment in affected sectors in the short run.

Changes in total trade and resulting changes in capital flows, interest rates, and exchange rates can have a disproportionate effect on the agricultural sector. The effect may be greater than specific changes in border measures or domestic policies relating to agriculture. For example, U.S. monetary policy during the 1980s has had a profound effect on the financial condition of the farm sector by producing higher interest rates and a stronger U.S. dollar, which increased farm costs while making U.S. farm exports less competitive. The strength of the U.S. dollar relative to the Canadian dollar has similarly influenced changes in the balance of agricultural trade between the two countries in the 1980s.

Exchange rates can also contribute to the adjustment process after trade barriers are lowered. Freer trade could cause the exchange rate to move in either direction. Because Canada's tariffs are generally higher than those of the United States, lowering trade barriers could cause Canada's imports to increase, producing a decline in the Canadian dollar relative to the U.S. dollar in the short run. However, in the longer run, freer trade could result in a favorable shift in Canada's competitive position due to efficiency gains that would increase exports from Canada, strengthening the Canadian dollar as foreign countries bid up its price. A stronger Canadian dollar would raise the price of U.S. imports from Canada, causing some decline in such imports. The exchange rate effect would, through the effect on prices, dampen any tendency for wholesale migration of industry from one country to another.

Other key issues that will influence the trade discussions between the two countries include: commodity stabilization policies, regional versus national effects of reducing trade barriers, the linkages between production agriculture and related industries and the resulting effects of policy changes, the interaction between subsectors in agriculture (such as grains and livestock) resulting from policy changes, and the potential structural change that could result from freer trade. While not exhaustive, this list indicates the complexity of issues and interests surrounding the trade negotiations.

## POLICY HARMONIZATION AND AGRICULTURAL TRADE

Policy harmonization means coordinating domestic and trade policies between countries in order to facilitate freer trade, while allowing each country to preserve a degree of domestic policy sovereignty. Policies that subsidize and insulate domestic producers and consumers from world market forces can have more influence on trade than specific border policies. Yet, it is unrealistic to expect that either country would dismantle all of its agricultural support and other domestic policies.

The fundamental problem of including agriculture in a free trade agreement is how to allow unrestricted or liberalized trade in agricultural products without dismantling all of the various price and income support and stabilization programs. Harmonization of these policies is one possible way to accommodate increased bilateral trade in some agricultural products while allowing each country to continue to provide some support to the agricultural sector.

The objective of policy harmonization is to achieve the theoretical gains from freer trade discussed earlier while allowing each country to pursue its domestic policy goals such as maintaining price and income stability, assuring a secure food supply, and preserving some desired farm structure. Policies pursuing these goals involve price stabilization and support, income support, input subsidies, marketing standards and stabilization, health and sanitary regulation, and others.

### Difficult Issues

In agriculture, some policy harmonization will be required if trade liberalization is to occur, most notably in the grains and dairy subsectors. Thus, concessions will have to be offered by one or both trading partners in return for the benefits of increased trade. Concessions may include equalizing protection, increasing market access, or reducing subsidies to the level of those in the country that subsidizes the least. Such changes in policies will alter relative prices and ultimately affect a country's trade position. Changes in trade patterns will produce winners and losers, which will generate political support and opposition. Governments will naturally be concerned with whether gains outweigh losses, how the gains and losses will be distributed, and the government's role in the adjustment process. Opposition to policy harmonization will arise most obviously from the industries or regions benefiting most from protection or support.

Restricting the benefits of harmonization to participants (avoiding the "free rider" problem) is a related issue. Effective harmonization would require that both countries lower tariffs and quotas on bilateral trade to the lower common level, but maintain existing trade barriers against third countries. Only then can the two free trade partners control the benefits. More comprehensive levels of policy harmonization would involve coordinating domestic policies, making it more difficult to restrict the benefits to participants because nonparticipants can benefit without offering compensating concessions. Reducing agricultural subsidies is feasible in a multilateral context, but difficult in a bilateral context. For example, even if the United States and Canada agreed to reduce subsidies to the wheat sector, both countries' world trade position could be jeopardized if the EC continued to subsidize wheat exports. For this reason, and because reducing agricultural subsidies is an agenda item in the ongoing multilateral trade discussions, bilateral reduction of subsidies is unlikely.

### Bilateral Policy Harmonization

In a bilateral agreement, it is easier to improve market access than to reduce subsidies. The common U.S.-Canadian border provides an opportunity to offer increased bilateral market access in commodities for which the two countries enjoy substantial transportation cost advantages over potential free riders. However, if border measures were equalized between the two countries but each country maintained its own tariffs and other restrictions against third countries, then some restrictions would have to be placed on transshipments of commodities from third countries.

Policy harmonization could be implemented in two ways, either: (1) directly through an explicit agreement by negotiators to a process in which border measures and domestic programs are made more consistent between the two countries; or (2) indirectly through changes in border measures that induce changes in policy through economic forces. For example, lifting the quota on poultry imports could compromise Canada's supply management program and thus force the poultry marketing board system to adjust. Some combination of the two approaches is probably more realistic, because trade negotiators cannot directly control domestic programs.

#### *Some Options*

Harmonization implies a wide range of options for coordinating agricultural policy across the border. Differences in protection, or support, as well as the institutions in each country will determine the opportunities for harmonization. Options range from the simplest, least comprehensive type of action, such as tariff harmonization, to coordination of domestic support programs or harmonization of legislation regarding taxes or import relief measures.

Harmonization of tariffs implies that both countries apply the same protection on imports of similar goods, with the lower of the two countries' tariffs being adopted. Tariff harmonization facilitates trade by producing a consistent categorization of traded products and equivalent tariffs for the same products moving in both directions across the border. If achieved in tandem with tariff reduction, as was done as a result of the 1979 Tokyo Round of the multilateral trade negotiations (MTN), this process can result in increased trade.

Harmonization could involve trade remedy laws, such as antidumping and countervailing duty regulations, which have been a source of contention between the two countries. Canada's complaints have centered on the unpredictability of how the United States applies its trade remedy laws (as in the softwood lumber case). U.S. complaints have focused on Canada's interpretation of GATT rules regarding what is countervailable. Some agreement on general guidelines could reduce the number of disputes, since neither country is likely to exempt the other from, or get rid of entirely, its laws. Areas of possible agreement include what types of support are countervailable, liberalization of the definition of material injury by increasing the *de minimis* level, or establishing a bilateral commission to hear trade disputes at an early stage.

## CONCLUSION

Trade across the lengthy Canadian-U.S. border, largely unhindered by tariffs or export subsidies, is nonetheless constrained by the indirect effects of government intervention policies such as price support programs or marketing orders. Free trade between the neighboring countries should aid consumers and taxpayers of both. But, Canada, the smaller nation facing a much larger potential market if trade were liberalized, stands to gain more. Harmonization of U.S.-Canadian policies--narrowing the differences between national policies--is one way to reduce government intervention and promote freer trade. But bilateral harmonization can backfire if third-party countries, while not reducing their own protection levels, grab a free ride in the market opened up by Canadian-U.S. negotiation. Yet the bottom line as suggested by trade theory remains. People on both sides of the border stand to gain. Even though there will be losses by some groups, the gains to society will outweigh the losses. Thus the keen interest in negotiating freer trade.

## ACKNOWLEDGMENT

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# CANADA-U.S. AGRICULTURAL TRADE: MARKET REALITIES AND OPPORTUNITIES

## Barry D. Mehr

I am glad to have this opportunity to speak to you on market realities for the agriculture and food sector in the context of the Canada-U.S. free trade negotiations.

As has been pointed out by other speakers here today, and as indicated by the extent of coverage given these matters in the media, U.S. producers and processors appear to have much less interest in bilateral trade issues than their Canadian counterparts. The United States is clearly a much more important market for the Canadian food and agriculture industry than vice versa. It is even more so for some regions (Quebec, Ontario, and Alberta), both currently and in terms of potential for growth.

I would like to focus my remarks on the situation in the different agricultural sectors since, as anyone familiar with agricultural issues will attest, there is no single market reality for agriculture but rather a series of realities that vary considerably according to the commodity market examined. Prior to focusing on the sectoral situation, I would like to make several more general points, recognizing that these issues have been or will be dealt with by other speakers at the symposium.

The first relates to the issue of government intervention, which both shapes and is shaped by market realities in agriculture. Many of the frustrations with which Canadian industry has to live are imposed from within the system in Canada. Large segments of the industry in Canada view the trade negotiations (both those with the United States and those in the GATT Round) as opportunities for Canada to set its own house in order in terms of government intervention with regulation and institutional mechanisms. I am sure that the same is true for many U.S. producers.

The degree and nature of government intervention has determined the market reality on both sides of the border. It has also determined trade flows between our two countries, price levels, and resource use. It is no wonder that agricultural trade liberalization poses many more problems than the removal of barriers on industrial products.

It would appear that as a global community we have reached a stage where there is a fuller appreciation of the cost of such intervention in terms of misallocated resources, instability in commodity markets, depressed commodity prices causing regressive global income distribution, and bitter trade relations such as have been experienced in recent years between the European Community and the United States.

Regarding the Canada-U.S. agricultural trade negotiations, I firmly believe that the agri-food sector in North America would be one of the major beneficiaries of a bilateral free trade agreement. I recognize that many farm and industry groups in Canada have expressed strong opposition to free trade in agri-food products. This opposition stems from a lack of understanding of the potential for long-term gains and of the costs imposed by our current system.

The short-term adverse impact of a free trade agreement on prices, incomes, and asset values in supply-managed sectors and the constraints it would impose on government policy and existing institutional arrangements are easily demonstrated and vocalized. This compares with the less tangible benefits flowing from much improved market opportunities, less control and regulation, reduced uncertainty, and less potential for trade harassment. Although it is often much simpler to argue for the same or more protection for agricultural products, in most cases the benefits of freer trade within North America would outweigh the costs.

In opposing free trade with the United States, many segments of the industry do not appreciate that this also may signal a rejection of a multilateral agreement. The disciplines imposed by a truly successful multilateral negotiation would be no less stringent than those of a bilateral agreement with the United States.

I would like to focus now on the key trade issues facing each of the major sectors within agriculture.

## KEY SECTORAL ISSUES FOR CANADIAN AGRICULTURE

### Cattle and Beef

There currently exists a healthy two-way trade in live cattle (breeding stock, feeders, and slaughter animals) and beef between the two countries. The United States is the major international livestock and meat market for Canada, although Canada supplies less than 1 percent of the U.S. beef requirements. Live cattle, semen, and embryo exports to the United States represent approximately 85 percent of Canadian cattle, semen, and embryo exports to all countries.

While tariffs are not an important issue except for the more processed meat products, there are numerous nontariff restrictions in place on both sides of the border that result in inefficiencies and additional costs for exporters. For example, health regulations differ significantly between the countries, and in the United States state requirements differ and can often take precedence over federal standards. In addition, the United States currently imposes a user fee on imports, which can represent a significant portion of beef sales margins. Canadian blue tongue testing requirements could be revised to support trade with the United States with little or no increase in the incidence of the disease in Canada. Trucking regulations on both sides of the border could be standardized and simplified, with benefits accruing in both countries. Both Canada and the United States have meat import laws that could limit market access. The United States has conducted a Section 332 investigation into Canada-U.S. beef and cattle trade at the request of U.S. industry interests. These items all reflect irritants or outright barriers to trade that need not exist.

In spite of the protection afforded the sectors in each country by these restrictions, the cattle and beef sectors in both countries could benefit from a reduction in or elimination of trade barriers. Under a free trade arrangement, the influence of regional production interests and efficiencies would likely result in different growth patterns in the two countries. For example, the United States would increasingly ship to eastern Canada, while the focus for the major producers in western Canada (particularly Alberta) would shift to the western United States.

### Hogs and Pork

As with cattle and beef, the United States is Canada's largest export market for live hogs and pork. Canadian exports of these commodities represent approximately 2 percent of the U.S. market. Because Canadian hog and pork production is surplus to domestic requirements, access to the U.S. market is particularly important for Canada. Pork and live hog trade between the two countries is subject to many of the same types of restrictions imposed against beef and cattle shipments. In addition, Canadian live hog exports are subject to a U.S. countervailing duty of 4.39 cents (U.S.) per pound. The countervail decision on hogs has raised questions regarding U.S. trade remedy laws and their application to raw and/or processed agricultural products. Aside from this action, there is a strong case for an open Canada-U.S. trading environment in live hogs and pork.

### Grains and Oilseeds

Bilateral Canadian-U.S. trade in grain and oilseeds is very small compared with their trade with the rest of the world. In 1986 Canada exported Can$225 million of these products to the United States, primarily wheat, barley, flaxseed, and soybeans and canola and their products (Statistics Canada, 1987a). U.S. exports to Canada in the same year totaled Can$425 million and consisted mainly of corn and soybeans and their products (Statistics Canada, 1987b).

Since both countries are excess producers of grain and oilseeds, the scope for two-way trade is limited. A variety of factors exists, however, that result in even lower trading volumes than would otherwise occur. These include Canadian transportation and handling limitations on shipments of grain and oilseeds to and from the United States, Canadian Wheat Board import licensing and pricing practices, and restrictive standards and handling regulations. Elimination of some or all of these impediments might open some regional markets and stimulate product flows, especially in times of shortage and in the interests of price arbitrage between the two markets.

Subsidies tend to pervade the markets for these crops and are a major issue both in the Canada-U.S. negotiations--as exemplified by the Canadian countervail of U.S. corn imports--and in the current GATT negotiations. The bilateral negotiations are unlikely to achieve any resolution of grain subsidy issues since most of the underlying problems are best dealt with in a multilateral context.

### Poultry and Eggs

The Canadian and U.S. poultry and egg industries have evolved very differently, with the Canadian industry under a system of supply management while the United States has moved to large, vertically integrated operations. Very little bilateral trade exists in these products. U.S. exports to Canada have increased over the past several years, even though they are directly tied to Canadian import quotas. Canada sells a small amount of eggs, turkey poults, and baby chicks to the United States.

Canadian supply management boards constitute the major barrier to trade in the poultry and egg industries. While a reduction in the power of these boards could provide some additional market opportunities, it would have to be carefully orchestrated to allow for orderly adjustment in the industry.

### Dairy

The dairy industries in Canada and the United States are highly regulated and subsidized and have strict health and sanitary standards. Both countries have global import quotas on key dairy products and surplus disposal mechanisms. The reality of the respective dairy policies/programs is such that industries in both Canada and the United States would be disadvantaged in a bilateral free trade arrangement. Consequently, any changes in dairy trade would be better dealt with on a multilateral basis.

Some opportunities exist for expanded regional trade such as easier access to the Canadian fluid milk market in exchange for increased Canadian cheese sales in the United States. Trade in specialty products not covered by quotas, for example yogurt and ice cream, could also be increased.

### Horticulture

While considerable progress has been made in the production and marketing of the more temperate climate vegetable and fruit crops, Canada continues to register a deficit in its trade of horticultural crops and products with the United States. The United States has an obvious climatic advantage and has developed significant economies of scale in some types of production. Marketing orders have enabled U.S. industry to control the quality and, at times, the volume of commodities marketed. On the Canadian side, trade barriers include seasonal tariffs, regulatory controls, direct government assistance, and marketing boards.

U.S. products will continue to dominate horticultural trade between the two countries although marketing opportunities will emerge for Canada such as the prospect of seed potato sales to the U.S. Pacific Northwest and carrot sales from eastern Canada to the northeastern United States. The potential for import replacement in Canada has also been enhanced by exchange rate factors, research and development, and reductions in transportation costs.

### Food and Agricultural Processing

The value-added processing elements of the agri-food industry represent one of the tangible areas of opportunity in the Canada-U.S. bilateral negotiations.

In 1986, Canadian exports to the United States of food and beverage products (including alcoholic beverages and soft drinks) totaled Can$2.2 billion, which was 60 percent of Canada's total global exports of those products and 68 percent of total agri-food exports to the United States (Agriculture Canada, 1988; Alberta Agriculture, 1987). U.S. exports of processed food products to Canada was Can$1.9 billion in 1986, approximately 9 percent of U.S. global exports and 53 percent of total U.S. agri-food shipments to Canada (Agriculture Canada, 1988).

Aside from being a large component of current Canada-U.S. agriculture and food trade, these products are major generators of economic activity. A high degree of investment, technology awareness, and sophistication are necessary to compete effectively in the international marketplace. This realization has led to the creation of a great many barriers to trade--both tariff and nontariff--as countries attempt to develop and expand these industries. Both the Canadian and U.S. governments enforce strict regulations on labeling, packaging, processing procedures, ingredients, and uses. Often there is a reluctance to accept other countries' standards or procedures.

The potential exists for substantial gains in the processed foods and agricultural products sector from bilateral free trade. These gains depend critically, however, on significant reductions in nontariff barriers. A removal of tariffs is not sufficient for achieving gains in this sector.

## CONCLUSION

Both Canada and the United States have much to gain in negotiating improved and more secure access to each other's markets for agriculture and food products. Trade flows based more on natural comparative advantage would both improve economic performance in the two countries and place North America in a more competitive position in the global agri-food marketplace.

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# A U.S. PERSPECTIVE ON MEASURING TRADE EFFECTS OF DOMESTIC AGRICULTURAL POLICIES IN THE UNITED STATES AND CANADA

## David Blandford

Experience has shown that it is extremely difficult to deal with agricultural products in international trade negotiations. In most industrialized countries, government intervention in agriculture is substantial and pervasive. Trade restrictions form an integral part of domestic agricultural programs whose objective is the support of producer prices and incomes. Even where explicit barriers to trade are not used, a variety of other government measures, for example subsidies, may distort international competition and trade flows.

## AGRICULTURAL POLICIES AND PROGRAMS IN THE UNITED STATES AND CANADA[1]

Both Canada and the United States have extensive farm programs designed to support farm incomes and prices, reduce price variability and production risks, and to assure a safe and adequate food supply for their populations. Border measures, in particular import quotas, are used by both countries as an integral part of supply management and price support programs.

### The United States

Farm programs in the United States generate direct and indirect support for prices and incomes (table 1). Loan rates provide cash flow for producers and a floor on market prices. Target prices, which are set above loan rates, are used to provide income support through deficiency payments when market prices fall below the target level. Acreage reduction programs are employed to manage supplies and to control government price support outlays. Both price and income supports are applied for grains and cotton. Price supports alone are used for dairy products and soybeans. A variety of other measures exist for sugar and certain other commodities.

When market prices are below target prices, deficiency payments provide a subsidy to domestic producers of wheat, most feed grains, rice, and cotton. If prices fall to the loan rate level, government support buying and storage generate an additional subsidy. The effects of these programs on production, international trade, and world prices is not straightforward. If acreage reduction programs are in effect, producers must comply with the acreage reduction requirement in order to be eligible for program payments.

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[1] This section draws upon unpublished information prepared by the U.S. Department of Agriculture (USDA).

TABLE 1. Major Instruments of Agricultural Policy in the United States

| Commodity | Price and income supports | | | | Trade measures | | | | | Other subsidies | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Target price | Loan rate | Direct purchases | Supply control | Tariffs | Quotas | Import licenses | Export subsidies | Food aid | Storage | Crop insurance |
| Wheat | x | x | | x | x | [a] | | x | x | x | x |
| Corn | x | x | | x | x | [a] | | [b] | x | x | x |
| Barley | x | x | | x | x | [a] | | x | | x | x |
| Sorghum | x | x | | x | | [a] | | x | | x | x |
| Oats | x | x | | x | x | [a] | | | | x | x |
| Soybeans | | x | | | | [a] | | [b] | | x | x |
| Rice | x | x | | x | x | [a] | | x | x | x | x |
| Cotton | x | x | | x | x | [a] | | x | | x | x |
| | | | | | | | | | | | |
| Cattle | | | | | x | | x | x | | | |
| Hogs | | | | | | | | | | | |
| Beef, veal | | | | | x | [c] | x | | | | |
| Pork | | | | | x | [c] | | | | | |
| Lamb | | | | | x | [c] | | | | | |
| Chicken | | | | | x | | | x | | | |
| Turkey | | | | | x | | | | | | |
| | | | | | | | | | | | |
| Eggs | | | | | x | | | x | | | |
| Fluid milk | | | | x | x | | x | | | | |
| Butter | | | x | | x | | | | x | | |
| Cheese | | | x | | x | | | | | | |
| Nonfat dry milk | | | x | | x | | | | x | | |
| Sugar | | x | | | x | [d] | | | | | |
| Potatoes | | | | | x | | x | | | | |
| Fruits & vegetables | | | | x | | x | | | | | |
| Tobacco | | x | | x | x | | | | | | |

*Source:* Based on information provided by USDA.

[a] Section 22 waiver.

[b] Subsidized exports of poultry feed and vegetable oils under the export enhancement program.

[c] 1979 Meat Import Act.

[d] Raw sugar imports restricted; other sugar imports under section 22.

Production may therefore be reduced, even though producers are being subsidized by the government. Because the United States is a large exporter of its major export commodities, government-subsidized reductions in production and purchases at the loan rate support both domestic prices and world prices. However, if acreage reduction requirements are set at low levels or commodities obtained under the loan program are exported through the use of export subsidies then these actions depress prices internationally.

Prior to 1986, the United States did not make widespread use of direct export subsidies. Since 1986, the Export Enhancement Program (EEP) has provided such subsidies for a wide range of agricultural commodities. Through this program exporters receive a bonus in the form of commodities from public inventories to enable them to reduce the price of exports of specified commodities to specified markets. The program has subsidized exports of grains, particularly wheat, in addition to eggs, poultry, and vegetable oil to more than fifty different countries at a cost to U.S. taxpayers of over $1 billion.

Although the effects of U.S. price and income support programs for grains and cotton may vary in their impact internationally, depending on how production and exports are affected, no such ambiguity exists for sugar and dairy products. The price support programs for both of these commodities rely heavily on the use of import quotas. In addition, the dairy program uses subsidized exports, primarily under food aid programs, to dispose of commodities surplus to domestic requirements. In an effort to reduce growing government purchases of surplus dairy products, a variety of measures have been tried in recent years to reduce production and increase demand. These have included the purchase and slaughter (or export) of dairy cattle, reductions in the support price based on the volume of surplus production, and the use of an assessment (tax) on milk sales to fund promotional and other activities designed to increase consumption. Despite these efforts, both the dairy and sugar programs restrict international trade and depress international prices.

Soybeans have not been subject to supply management. Price support levels for soybeans have generally been sufficiently low that they have not resulted in the accumulation of stocks. As a result, trade has not been affected significantly by the price support program. There are no price supports for beef, pork, poultry, or eggs. Imports of beef and veal are covered by "voluntary" export controls by the major exporters (Australia and New Zealand). When prices are low these controls provide a measure of support to domestic beef producers.

## Canada

Like the United States, Canada has a wide range of domestic agricultural programs (table 2). The Agricultural Stabilization Act (ASA) provides a mechanism for price support for beef cattle, hogs, sheep and lamb, industrial milk and cream, corn, soybeans, and wheat, oats, and barley grown outside the designated area of the Canadian Wheat Board (CWB). The price floors under the Act are based on average market prices in previous years, adjusted for changes in production costs. Deficiency payments are made if the market price falls below the floor price. Actual payments have been largely confined to industrial milk and cream.

Within the designated area of the CWB, the Western Grain Stabilization Act (WGSA) of 1976 provides revenue stabilization to producers. This program is partly funded by producer contributions but has the potential to provide a substantial government subsidy. Two-thirds of the costs are paid by the federal government. Prior to 1984 payments under the program had been infrequent; in recent years they have been substantial.

TABLE 2. Major Instruments of Agricultural Policy in Canada

| Commodity | Price and income supports | | | | Trade measures | | | | | | Other subsidies | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Full cost price | Floor price | Margin support | Supply control | Tariffs | Quotas | Import licenses | Export subsidies | Food aid | State trading | Storage | Crop insurance |
| Wheat | | x | x | | x | | x | | x | x | | x |
| Corn | | x | | | x | | | | | | | x |
| Barley | | x | x | | | | x | | x | x | | x |
| Sorghum | | | | | | | | | | | | |
| Oats | | x | x | | | | x | | | | | x |
| Soybeans | | x | | | | | | | | | | x |
| Rice | | | | | x | | | | | | | |
| Rapeseed | | | | | | | | | | | | x |
| Cattle | | | x | | x | | | | | | | |
| Hogs | | | x | | | | | | | | | |
| Beef, veal | | | | | x | x | x | | | | | |
| Pork | | | | | x | | | | | | | |
| Lamb | | | x | | x | | | | | | | |
| Chicken | x | | | x | x | x | x | x | | x | | |
| Turkey | x | | | x | x | x | x | x | | x | | |
| Eggs | x | | | x | x | x | x | x | | x | | |
| Fluid milk | x | | | x | x | x | x | x | | x | | |
| Butter | x | | | x | x | | x | x | | x | | |
| Cheese | x | | | x | x | x | x | x | | x | | |
| Nonfat dry milk | x | | | x | x | | x | x | x | x | | |
| Sugar | | x | x | | x | | | | | | | |
| Potatoes | | | x | | x | | | | | | x | x |
| Fruits & vegetables | | | x | | x | | | | | | | x |
| Tobacco | | | x | | x | | | | | | | |

*Source:* Based on information provided by USDA.

The provincial governments in Canada play a significant role in farm programs (see Coffin's paper in this volume). The provinces have a wide variety of support or commodity stabilization programs of their own, many of which are designed to augment ASA payments. Fluid milk is one product in which provincial control is important, and the price support program is highly restrictive of international trade. Producer prices are set on the basis of estimated costs of production, and output is limited by production quotas. Little milk crosses provincial boundaries and none can be imported from the United States. Industrial milk has a target price/deficiency payment system implemented through a government offer to purchase. As in the case of the United States, import quotas are an essential part of the price support system. There are also restrictions on imports and use of substitute dairy products. Exports of surplus quantities of dry skim milk are subsidized, but these are financed by producer levies.

Production quotas are an integral part of the provincial programs for broilers, turkeys, and eggs. Consumer prices are higher for these products than in the United States. Quotas are used to control imports from the United States. Trade in beef and pork is not subject to quantitative controls.

## Analyzing the Effects of Agricultural Policies

One way in which the implications of the various forms of U.S. and Canadian government intervention in the agricultural sector can be evaluated is through partial equilibrium market analysis. For example, consider the case in which the government attempts to support the incomes of domestic producers of a given commodity by imposing a tariff on imports. For the moment it will be assumed that the country is a "small" importer in that changes in its imports of the commodity affected have no significant impact on world prices.

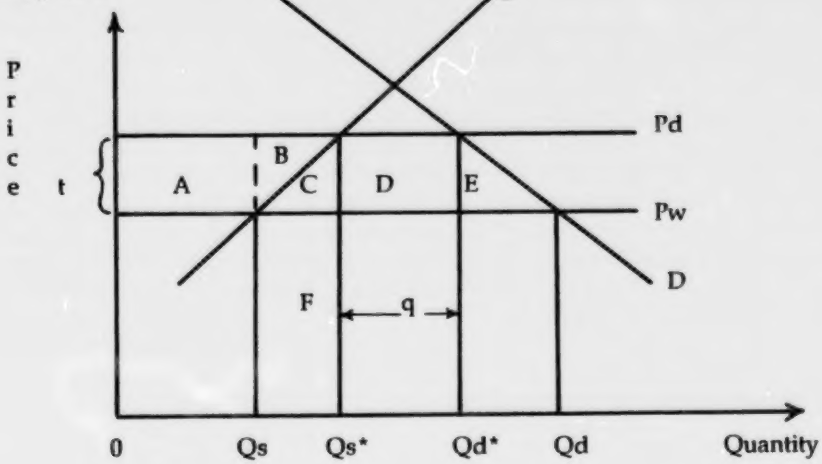
In panel A of figure 1 the tariff t is added to the import price Pw in order to increase domestic prices to Pd. As a result of the higher domestic price, domestic supply increases from the pre-tariff level of Qs to the quantity Qs*, and demand falls from Qd to Qd*. Imports are reduced from Qd-Qs to Qd*-Qs*.

The tariff generates a series of economic transfers. Total producer revenues increase by the sum of the areas A,B,C, and F. However, F and C are spent on the additional variable inputs, such as fertilizer, chemicals and hired labor, needed to increase production. The net income of producers is increased by the smaller amount A+B. Consumers are also affected by the tariff. For them the increase in price due to the tariff is equivalent to a consumption tax. Their real income is reduced by the area A+B+C+D+E. One way to view this area is as a measure of the financial payment which would have to be made to consumers to compensate them for the increase in price produced by the tariff. Finally, taxpayers gain from the policy since the government collects the tariff revenue denoted by the area D.

If the sum of the gains to producers and taxpayers and the loss to consumers is calculated, it is apparent that there is a net loss of C+E as a result of this policy. This is referred to as the "deadweight loss" by economists. The first component of this loss, represented by C, is due to the increased cost of producing Qs*-Qs of the commodity domestically rather than importing it. The upward-sloping supply curve reflects the fact that additional domestic production can only be achieved at higher cost because of the limited supply of some inputs, most usually land in the agricultural case. The second component of the deadweight loss, area E, is simply part of the change in the real income of consumers that is not redistributed to anyone as the result of the tariff. It is simply the loss to society as a whole as a result of the lower level of consumption.

One of the simplifying assumptions made in figure 1A is that changes in the imports of the country imposing the tariff are insignificant relative to the total volume of world

A. Small country case



B. Large country case

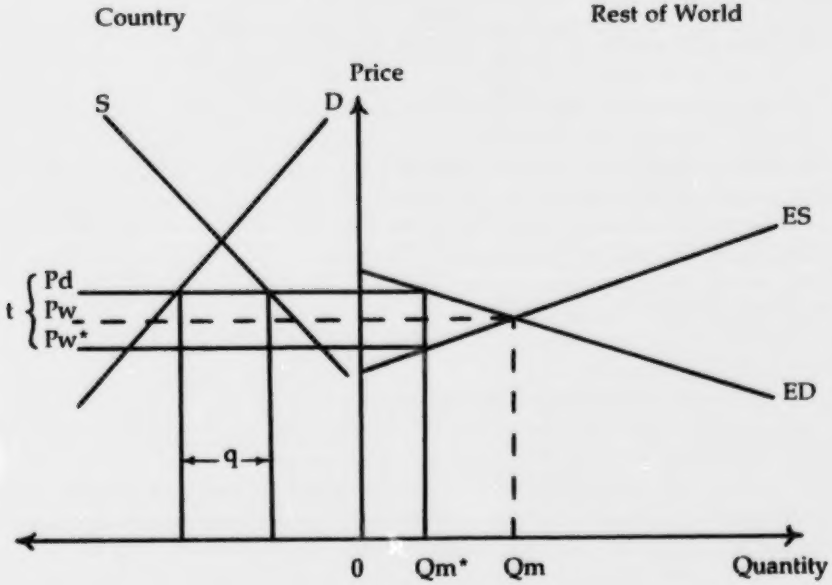


FIGURE 1. Trade effects of an import tariff or quota: (A) small country case and (B) large country case.

volume of world trade. As a result, the actions of the importing country have little effect on the rest of the world. Much of the conflict that exists between countries over domestic agricultural and trade policies is generated because other countries are affected by the changes in trade volumes resulting from government intervention. Panel B of figure 1 depicts the case of a "large" importer. Such an importer faces an upward-sloping supply curve from suppliers in world markets (ES); because of its size the country can only obtain additional imports at an increasing price per unit. The left part of the diagram shows the situation in the domestic market while the right part of the diagram captures effects in the international market. Because the country's imports are significant in world terms, its imposition of a tariff, and the consequent reduction in its imports, causes the world price to fall from Pw to Pw*. Not only are domestic consumers affected negatively by the government's policy, but foreign exporters are also affected negatively by the fall in world price.

Both the United States and Canada use import tariffs on agricultural products, in addition to a variety of other measures such as quotas and subsidies. The same basic framework illustrated by figure 1 can be used to evaluate the impact of these measures. For example, the government could generate the same increase in producer income in figure 1A by imposing an import quota equal to q. The ultimate fate of the transfer represented by area D, termed the quota "rent," depends on how the quota is allocated. If the quota were given to importing firms, they would realize D. The firms would be able to purchase the commodity on the world market at the price Pw, sell on the domestic market for Pd and keep the difference. If the government decided to give the quota to particular supplying countries or to negotiate "voluntary export restraints" (VERs) with these suppliers, they would be able to realize D by making sure they priced their quota exports at Pd. The government could also obtain D for taxpayers by holding a competitive auction for the quota. Under such a system the maximum price bid per quota unit would be Pd-Pw.

Government policy measures that do not increase domestic consumer prices above world market prices generate a resource cost but no consumer cost. For example, instead of restricting imports through a tariff or quota the government might set a guaranteed price for domestic production at Pd and pay producers a deficiency payment of Pd-Pw while leaving the consumer price at Pw. This would create the same transfer of A + B to producers and the resource cost of C, but imports would only be reduced by Qs*-Qs and there would be no cost imposed on consumers. However, taxpayers would have to foot the bill for the deficiency payments by paying A + B + C.

One particularly relevant example in the U.S.-Canada context are policies that generate higher producer prices but also involve production controls. For example, suppose that in figure 1A the import tariff is combined with a quota on domestic production set at Qs. In this case the net transfer to producers would be reduced by area B, the resource cost of C would be saved, imports would be larger by Qs*-Qs, and the government would collect additional revenue from the tariff equal to B + C.

The partial equilibrium framework, although simple, demonstrates that trade and domestic agricultural policies generate significant redistributive effects. Programs that increase domestic prices generate a transfer of real income from consumers to producers. When the price increase is achieved through an import quota, there is a transfer from consumers to quota holders. If it is achieved through a tariff, the transfer is from consumers to the government (taxpayers). Programs that provide subsidies to producers (deficiency payments, input or transportation subsidies, or export subsidies) result in a transfer from the government to producers. In the large country case there is also a transfer to consumers because of the price-depressing effects of higher production.[2]

Table 3 summarizes the implications of some of the major types of agricultural policy measures used by Canada and the United States at the producer, consumer, and trade levels and their implications for domestic prices, production, consumption and trade volumes, and government expenditures. It demonstrates that most of the domestic policy measures, which are not directly related to trade, nevertheless have implications for the volume of trade. This is one of the principal factors affecting U.S.-Canada trade in agricultural products and has significant implications for how such trade might be liberalized.

One of the major objectives of government intervention in agriculture in both Canada and the United States is to increase agricultural incomes. The framework illustrated above suggests that many forms of intervention do increase the aggregate net income of producers in the short term. However, in the longer term it is difficult to achieve a sustained increase in net producer income through such policies. The increase in net income will cause the price of the fixed factors used in agriculture, particularly land, to increase. The price of land in the marketplace reflects its profitability. As this profitability increases, so will the cost of acquiring land for new entrants to farming or for existing farmers who wish to expand. The current owners of land benefit from this situation since the value of their assets increases, and they can realize a capital gain should they decide to sell. The purchasers of land do not benefit. For them the increased value of land represents an increase in the cost of production. The income generated by government policies simply covers the higher cost of production generated by these policies. In the longer term, therefore, the increase in net income generated by trade or domestic policy measures is dissipated.

The same phenomenon also applies to production quotas. Since the possession of quota allows the owner to realize the added income derived from production at higher prices, the quota itself has value. The quota becomes an asset with a price that reflects the income to be derived from its possession. This means that the owner of quota will realize a capital gain when the quota is sold, either directly or as part of a farm property transaction. Again, for the new entrant or expanding producer the cost of the quota becomes a cost of production. The initial increase in net income generated through the quota restriction on production is eventually dissipated.[3]

The essential and rather depressing reality of agricultural policy intervention aimed at increasing producer incomes is that such policies are only successful, if at all, in the short run. In the longer term they cannot achieve a sustained increase in the net income of producers. Only by continuously raising the level of intervention, and its cost to other groups in society, can net farm income be increased through trade or domestic agricultural policy measures.

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[2] There are also significant distributive effects within these groups. As an example, see Blandford's recent analysis of the distribution of direct payments across producers in the United States.

[3] Warley provides estimates of the cost of entry generated by supply control schemes in Ontario in 1984. For a typical family-sized unit these range from Can$180,000 for a dairy farmer to Can$750,000 for an egg producer.

TABLE 3. Effects of Major Types of Agricultural Policy Interventions

| | Producer measures | | | | Trade measures | | | Consumer measures | |
|---|---|---|---|---|---|---|---|---|---|
| | Support purchases | Deficiency payments | Input subsidies[a] | Production quotas | Tariffs | Quotas | Export subsidies | Taxes | Subsidies |
| Producer prices | + | + | | + | + | + | + | b | c |
| Consumer prices | + | | d | + | + | + | + | + | – |
| Production | + | + | + | | + | + | + | b | c |
| Consumption | – | | d | – | – | – | – | – | + |
| Trade[e] | f | – | – | f | – | – | +[g] | – | + |
| Government expenditure | + | + | + | | – | h | + | – | + |

[a] Also applies to marketing subsidies, e.g., for storage or transportation.

[b] In the large country case prices and production could be reduced.

[c] In the large country case prices and production could be increased.

[d] Consumer prices may decline and consumption increase in the large country case.

[e] Net imports.

[f] Usually combined with import controls.

[g] Net exports.

[h] Unaffected unless quotas are auctioned, in which case negative.

## THE LEVEL OF INTERVENTION IN THE UNITED STATES AND CANADA

While the theoretical basis for analyzing the effects of domestic agricultural policies is well developed, recent empirical estimates of the level of government intervention in the United States and Canada are limited. The derivation of such estimates requires a substantial amount of information and is time consuming. In some cases, the information needed to derive estimates is difficult to obtain. In the U.S.-Canada context this is particularly true for state and provincial policies, as distinct from federal programs.

Recently, the Organization for Economic Cooperation and Development (OECD) has been engaged in a major study of the level and effects of government intervention in agriculture in its member countries. The approach used by the OECD has also been adopted by the USDA in order to monitor agricultural intervention worldwide. Some of the results of the USDA's efforts have recently been published (U.S. Department of Agriculture, 1987).

The OECD methodology is based upon that developed by Josling for the UN Food and Agricultural Organization during the early 1970s (Food and Agriculture Organization of the United Nations, 1975). Estimates of the magnitude of intervention are captured through the calculation of a subsidy equivalent. The producer subsidy equivalent (PSE) denotes the level of direct payment or income subsidy that would be necessary to compensate producers for the removal of existing government programs.[4] The consumer subsidy equivalent (CSE) is the parallel concept for consumers. Typically, the PSE is positive, reflecting the fact that most programs increase gross producer incomes; the CSE is negative, reflecting the fact that many programs reduce the real incomes of consumers through increasing prices.

A PSE is estimated by evaluating the individual impact of each government policy on gross income, and then summing the components. The components are derived from figures on government budgetary expenditures, and from information on the relationship between domestic and border or international prices. The CSE is estimated from differences between internal and external prices, but also incorporates the effects of government expenditures that affect consumers directly but are not reflected in market prices, (e.g., those through school lunch programs). When a package of related domestic and trade measures is employed, the combined effect of the measures on internal prices is evaluated, rather than their separate components, in order to avoid double counting. For example, in the case of the U.S. dairy program, the combined effect of government support purchases of dairy products and import quotas is estimated from the difference between domestic support prices and comparable world prices.

The PSE estimates are expressed as a percentage of the domestic value of production including direct payments. The CSE estimates are expressed as a percentage of consumer expenditures on the product. The USDA estimates relate to major federal programs in the countries concerned and do not include any additional effects of state or provincial programs. In the U.S.-Canada context this is a significant omission.

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[4] In actual fact there are at least three definitions of the PSE, all of which have been used in different contexts. The OECD definition includes government expenditures that are unlikely to result in a transfer of income to producers, such as expenditures on research and extension. The PSE as originally used by FAO ignores such expenditures and includes only producer income transfers. Finally, there is the concept of the "supply-inducing" PSE. This is the subsidy that actually affects supply and hence trade. Subsidies that are not related to production or whose impact is offset by supply controls are excluded. This measure of the PSE has been used by the OECD to estimate the effects of domestic agricultural programs on trade. The PSE is a complex concept, which limits its usefulness in trade negotiations.

There are many problems, including theoretical and empirical limitations, that have to be overcome in estimating PSEs and CSEs. One of the most important theoretical limitations is that the subsidy equivalents are estimated using the small county assumption, that is the situation depicted in figure 1A above. Large country effects on prices and transfers are not taken into account.[5] As such, the measures provide only a rough guide to the level of intervention within a given country or across countries. There are other approaches that can yield more precise estimates of the net effect of intervention but these are more complicated to derive and to understand. Despite their limitations, the PSE/CSE measures provide a useful indicator of the effects of government intervention.

In the USDA study the estimated subsidy equivalents relate to an average level of support for the 1982-84, and are therefore dated. The recent increases in support (particularly direct payments) resulting from the 1985 Food Security Act in the United States are not captured, although the substantial expenditures under the 1983 Payment in Kind (PIK) program are included. Because of the substantial year-to-year variation in agricultural prices, and consequently in the absolute level of government support, the absolute size of the estimated transfers can be highly variable. However, the ranking of commodities by level of support is less variable.

A summary of the estimates derived by the USDA for the United States and Canada is given in table 4. The results for implicit producer subsidies generated by existing programs are given in the top part of the table; the implicit consumer taxes are given in the lower part of the table. In recognition of the approximate nature of the estimates, only a range of values is presented and commodities are classified according to these ranges. Not all commodities are included; particularly important omissions in the context of U.S.-Canada trade liberalization are eggs, fruit and vegetables, and processed agricultural products.

At the federal level, both countries provide little support to their meat producers or to soybeans. The sole exception is poultry meat in Canada. Both countries provide support to basic grains such as wheat, barley, and corn. In general the level of federal support provided to producers by U.S. programs is higher than that in Canada. Most of the PSEs for grains in the United States fall in the range of 25-49 percent of the value of output, compared to the 10 to 24 percent range in Canada. The most heavily supported commodities (in the 50-74 percent range) are milk and dairy products in Canada and sugar in the United States. The support provided to dairy producers in Canada is larger than in the United States; the reverse is true in the case of sugar.

The estimated consumer subsidy equivalents suggest that consumers pay significant implicit taxes on milk and dairy products in both countries and on sugar in the United States. For the remainder of the commodities the implicit consumer tax is less than 10 percent of consumer expenditures. The low implicit consumer tax in comparison to the higher implicit producer subsidy for many commodities, reflects the fact that substantial proportion of the assistance provided by the United States and Canada is in the form of direct government subsidies. In the United States these are provided by deficiency payments and related measures under price support programs; in Canada they are provided by transportation subsidies and income stabilization payments.

Table 5 shows the proportion of the estimated produced subsidy equivalent that can be attributed primarily to border measures such as tariffs and quotas. Border measures are

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5. Note also that the subsidy equivalent estimates do not show the net effect of government intervention. The PSE for livestock reflects those policies that influence revenues but not costs, for example, through feed prices. A net estimate of the effect of government intervention can be obtained through an adjusted or effective rate of assistance (Strak, 1982).

TABLE 4. Estimated Producer and Consumer Subsidy Equivalents of Agricultural Policy Measures, 1982-84

| | Percent | | | |
|---|---|---|---|---|
| | 0 to 9 | 10 to 24 | 25 to 49 | 50 to 74 |
| *Producer subsidy*[a] | | | | |
| Canada | Beef<br>Corn<br>Oats<br>Pork<br>Soybeans | Barley<br>Flaxseed<br>Poultrymeat<br>Rapeseed<br>Rye<br>Wheat | Sugar | Dairy |
| United States | Beef<br>Pork<br>Poultrymeat<br>Soybeans | Barley | Corn<br>Cotton<br>Dairy<br>Rice<br>Sorghum<br>Wheat | Sugar |
| *Consumer tax*[b] | | | | |
| Canada | Barley<br>Beef<br>Corn<br>Flaxseed<br>Oats<br>Pork<br>Poultrymeat<br>Rapeseed<br>Rye<br>Soybeans<br>Sugar<br>Wheat | Butter<br>Cheese | Fluid milk | |
| United States | Beef<br>Pork<br>Poultrymeat | Cheese<br>Fluid milk | Butter<br>Nonfat dry milk | Sugar |

*Source:* USDA (ERS), *Government Intervention in Agriculture,* FAER-229 (April 1987), tables 4 and 5.

[a] Ratio of policy transfers to gross domestic value of production including direct payments.

[b] Ratio of policy transfers to consumer expenditure on the product.

TABLE 5. Proportion of Producer Subsidy Equivalent from Agricultural Policies Attributable to Border Measures, 1982-84

| | Percent | | | | |
|---|---|---|---|---|---|
| | 0 to 9 | 10 to 24 | 25 to 49 | 50 to 74 | 75 to 100 |
| Canada | Barley<br>Corn<br>Pork<br>Rapeseed<br>Soybeans<br>Wheat | Beef | Poultrymeat<br>Sugar | Dairy | |
| United States | Barley<br>Corn<br>Cotton<br>Pork<br>Poultrymeat<br>Rice<br>Sorghum<br>Soybeans<br>Wheat | | Beef | | Dairy<br>Sugar |

*Source:* USDA (ERS), *Government Intervention in Agriculture*, FAER-229 (April 1987), table 7.

particularly important for milk and dairy products in both countries and for sugar in the United States. These commodities are protected by import quotas in both countries. In light of the size of the producer subsidy shown in table 4, the only other cases where border measures are significant are sugar and poultry meat in Canada.

## IMPLICATIONS OF CHANGING GOVERNMENT PROGRAMS IN THE UNITED STATES AND CANADA

In addition to the calculation of the subsidy equivalents of policies, the USDA has been attempting to calculate what the effects might be on U.S.-Canada trade if the level of government intervention in agriculture were reduced or its form altered. Despite the inefficiencies of existing programs in transferring income to producers, these programs are extremely difficult to change. Given the political problems that would be involved, some combination of a reduction in the level of support and a change in the nature of support may be a more realistic option for liberalizing U.S.-Canada agricultural trade.

The USDA has constructed an empirical model to assess the impact of bilateral liberalization on the products included in tables 4 and 5. The model is static and long run in nature. It calculates the long-run impact of changes in the subsidy equivalent of government policies on the volume and value of trade between the two countries and with the rest of the world, using 1984-85 as a base year. The basic model employed has been described in Roningen (1986), and Dixit and Roningen (1986).[6]

Table 6 summarizes the estimated effects on trade flows of two different policy scenarios (Dixit and Roningen, 1986). In the first scenario only border measures affecting U.S.-Canada trade are eliminated.[7] In the second scenario, the implicit producer subsidy resulting from existing farm policies is maintained, but the implicit consumer tax is eliminated. This is equivalent to the replacement of policies that increase domestic consumer prices by direct payments to producers. Table 7 summarizes the effects of these two scenarios on the economic welfare of producers and consumers in the two countries.[8]

One of the major implications of the figures presented in table 6 is that the simple elimination of border restrictions on U.S.-Canada trade would have only a modest effect upon cross-border trade for most of the commodities analyzed, oil meals, cheese, and poultry meat being exceptions. Table 7 suggests that producers, particularly those of animal products, would gain in Canada but that the net "welfare" effect would be about $5 million in both countries. The major beneficiaries of the elimination of border restrictions would be producers in the rest of the world. Without these restrictions in the

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[6] One of the major features of this model is its assumption that the commodities traded are not perfectly homogeneous. Hence, beef produced in Canada is viewed to be a different commodity from beef produced in the United States. The two commodities are not perfect substitutes in consumption.

[7] Since in some cases border measures are an integral part of domestic support programs, this would be extremely difficult to achieve in practice. The model simply reflects the impact of eliminating the producer subsidies/consumer taxes attributable to border measures rather than the elimination of border restrictions per se.

[8] The welfare estimates are the empirical counterparts to those in figure 1.

TABLE 6. Estimated Changes in Bilateral Trade Flows with U.S.-Canada Agricultural Trade Liberalization--Change from 1984-85 Levels

(in percent)

| | | Change in border measures only Imports by: | | | Change in domestic policies and border measures Imports by: | | |
|---|---|---|---|---|---|---|---|
| Commodity | Exports from | U.S. | Canada | Other (rest of world) | U.S. | Canada | Other (rest of world) |
| Beef | U.S. | | 2 | | | 3 | |
| | Canada | 2 | | | 2 | | |
| | Other | | | 0 | | 0 | |
| Poultrymeat | U.S. | | 14 | | | 23 | |
| | Canada | 1 | | | 2 | | |
| | Other | | | -1 | | -1 | |
| Butter | U.S. | 0 | | | | | -0 |
| | Canada | | | | | | |
| | Other | | | | | | |
| Cheese | U.S. | | 0 | | | 51 | |
| | Canada | 15 | | | 133 | | |
| | Other | | 0 | | | 1 | |
| Other dairy[a] | U.S. | | -0 | | | 84 | |
| | Canada | -0 | | -0 | 40 | | |
| | Other | | | | | | |
| Corn | U.S. | | 2 | | | 2 | |
| | Canada | 1 | | 0 | 1 | | 1 |
| | Other | | | | | | |
| Soymeal | U.S. | | 1 | 0 | | 1 | 0 |
| | Canada | -1 | | | -7 | | |
| | Other | | 1 | | | -1 | |
| Other oilmeals | U.S. | | 9 | 100 | | 9 | 117 |
| | Canada | 50 | | -14 | 50 | | -14 |
| | Other | | | | | | |
| Vegetable oils[b] | U.S. | | | | | | |
| | Canada | 3 | | | 5 | | |
| | Other | | | | | | |

*Source:* P. M. Dixit and V. D. Roningen, "Quantitative Impacts of Creating a Free Trade Area Between the U.S. and Canada," paper presented at the annual meetings of the Northeast Agricultural and Resource Economics Association, Kingston, R.I., June 24-25, 1987.

[a] Primarily milk powder.

[b] Excluding soy oil.

TABLE 7. Estimated Gains/Losses Resulting from U.S.-Canada Agricultural Trade Liberalization

(in US$ millions)

| | Elimination of border measures only | | | Elimination of implicit consumer tax | | |
|---|---|---|---|---|---|---|
| | Producers | Consumers | Net | Producers | Consumers | Net |
| Canada | | | | | | |
| Animal products | 5 | -1 | 4 | 20 | -6 | 14 |
| Crops | 1 | 0 | 1 | 1 | -1 | 0 |
| Total | 6 | -1 | 5 | 21 | -7 | 14 |
| U.S. | | | | | | |
| Animal products | -3 | 8 | 5 | -3 | 20 | 17 |
| Crops | 0 | 0 | 0 | 1 | 0 | 1 |
| Total | -3 | 8 | 5 | -2 | 20 | 18 |
| Rest of world | | | | | | |
| Animal products | 9 | -4 | 5 | 33 | -32 | 1 |
| Crops | 13 | -6 | 7 | 17 | -10 | 7 |
| Total | 22 | -10 | 12 | 50 | -42 | 8 |
| World | | | | | | |
| Animal products | 11 | 3 | 14 | 50 | -18 | 32 |
| Crops | 14 | -6 | 8 | 19 | -11 | 8 |
| Total | 25 | -3 | 22 | 69 | -29 | 40 |

*Source:* P. M. Dixit and V. O. Roningen, "Quantitative Impacts of Creating a Free Trade Area Between the U.S. and Canada," paper presented at the annual meetings of the Northeast Agricultural and Resource Economics Association, Kingston, R.I., June 24-25, 1987.

United States and Canada domestic prices would be lower, and production would fall.[9] Producers in the rest of the world would benefit from the reduction in North American production and the consequent increase in world market prices.

In comparison to the modest impact of the elimination of border measures alone, the elimination of the implicit consumption tax associated with existing policies would have a substantial effect on U.S.-Canada trade. There would be a significant expansion of trade in dairy products and poultry meat. Cross-border trade in cheese and other dairy products (primarily milk powder) would expand substantially. Table 7 suggests that the major beneficiaries of this change in policy would be Canadian farmers, particularly livestock farmers, and U.S. consumers.

Producers in the rest of the world would also benefit because of the higher prices generated by the expansion in North American demand. However, unlike the border liberalization scenario, the United States and Canada pick up most of the gains, rather than the rest of the world. On the basis of the estimates presented in the table, the gains to the United States and Canada from the change in domestic policy measures are more than three times as large as those from the elimination of trade restrictions alone.

Although quantitative estimates are not available, it is likely that a reduction in the implicit subsidy to producers provided by current domestic farm programs would also have a significant impact on trade between the two countries. Domestic farm programs are the major factor influencing U.S.-Canada trade. Changes in these programs would have a much more significant effect on the trade in agricultural products between the two countries than changes in border measures alone.

## CONCLUSIONS

Because of limitations of space and information this paper has only been able to provide a partial analysis of the impact of current domestic agricultural policies on U.S.-Canada trade. Some of the agricultural commodities that could be affected significantly by U.S.-Canada trade liberalization, such as fruits and vegetables or processed food products, have not been included. Nor have the effects of many state and provincial programs been considered. Nevertheless, the results suggest that agricultural programs in the United States and Canada have a significant effect on U.S.-Canada trade. While the border measures employed by the two countries are a factor, changing border measures alone would probably not lead to a major expansion in agricultural trade between the two countries. In order to realize the full benefits of more liberal trade, changes in domestic agricultural programs would be necessary, with all the difficulties that this entails.

Despite the questionable effectiveness of U.S. and Canadian agricultural programs as a means of supporting producer incomes, it is extremely unlikely that these programs would be abandoned overnight in the search for freer trade. Nevertheless, a gradual process of liberalization could begin as the result of the bilateral negotiations. At a minimum, this process would involve: (1) the harmonization of phytosanitary and health restrictions; (2) the phased elimination of tariffs; and (3) a phased increase in import quotas for dairy and poultry products, with corresponding adjustments in domestic support programs for these commodities.

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[9] Note that it is possible for producers or consumers to be net losers. Even with the replacement of the tax by an equivalent direct payment, producer incomes may still fall because of the change in demand, trade, and prices. Similarly, consumers may be worse off if prices rise because of the change in supply and demand by more than the reduction in the implicit tax.

These changes would be manageable within existing institutions and policies if they were implemented gradually. Gradual change would smooth the process of adjustment and make it easier to absorb adjustment costs. In the event that these costs were large or were viewed to be unacceptable, the exit of producers or the reduction of processing capacity could be achieved through a program of adjustment assistance. If politically necessary, compensation for the loss of asset values resulting from liberalization could also be paid. Such compensation would be inexpensive in comparison with the costs imposed on consumers by protection and the gains likely as the result of freer trade between the two countries.[10] Regional or other social objectives could continue to be pursued through the use of direct payments, unrelated to production. Such payments could be designed so as not to distort competition or trade and could be targeted more effectively than price supports (Blandford, 1987).

In effect, the difficulties that face the United States and Canada in attempting to deal with their agricultural programs on a bilateral basis are a microcosm of the problems facing agriculture worldwide. The effective liberalization of agricultural trade can only be achieved by changing both agricultural trade policies and domestic agricultural policies. Despite the difficulties, it should be possible for the United States and Canada to achieve significant progress on the liberalization of agricultural trade, although there will inevitably be some commodities that will need to be handled in a multilateral context (e.g., sugar and grains). Such progress would set a desirable and important precedent for the current multilateral negotiations in agriculture under the General Agreement on Tariffs and Trade. Without significant progress in the bilateral and multilateral negotiations, agricultural trade is destined to remain a distorted residual product of domestic agricultural programs. In the longer term, this would be harmful to the agricultural sectors of both countries and to their broader national interests.

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[10] See Harbert and Blandford (1980) for an earlier analysis of how this might be done for sugar in the United States.

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# A CANADIAN PERSPECTIVE ON MEASURING TRADE EFFECTS OF DOMESTIC AGRICULTURAL POLICIES

**H. Bruce Huff**

## INTRODUCTION

Canada and the United States are very important agricultural export markets for each other. Agricultural producers in both countries, however, have reservations about the bilateral trade negotiations. U.S. producers have seen a decline in their competitive position in Canadian and third-country markets as a result of the strength of the U.S. dollar. Canadian producers are concerned about the vulnerability of their market from a country ten times their size. Naturally, the producers in both countries whose commodities are most protected from market forces are those most concerned about possible changes. On the other hand, some policymakers view the U.S.-Canada bilateral negotiations as an opportunity for serious consideration of a reform of trade-distorting domestic agricultural policies that would serve as an example to other partners in the General Agreement on Tariffs and Trade (GATT) prior to the current round of multilateral negotiations.

Tariffs affecting U.S.-Canada agricultural trade are relatively low, following large reductions and harmonization under the previous rounds of GATT negotiations. Hence it is nontariff trade measures, many of which exist to support domestic agricultural programs where significant trade restraints occur (see the paper by Prentice and Menzie in this volume for a discussion of formal and informal nontariff barriers). Reducing government support levels and at the same time attempting to harmonize or reconcile these complex, diverse domestic programs in order to enhance trade would be a difficult task. A basic understanding and assessment of the price and trade impacts of these programs are therefore an important part of any such trade negotiations. In measuring these price and trade effects, it is also important to account for the close linkages among commodities and market levels and how changes affect third countries.

The next section of this paper reviews aggregate measures of trade protection due to domestic policies and provides estimates of support levels for provincial/state programs for selected commodities. The following section concentrates on some empirical examples, discussing the results of several simulation studies for selected commodities and the usefulness of such studies for analyzing bilateral agreements. The fourth section raises some of the implementation difficulties involved in any attempt to harmonize policies including quality assurance, income stabilization, supply control, and regional concerns. The final section offers some concluding observations on liberalization of U.S.-Canada trade.

## APPROACHES TO MEASURING THE EFFECTS OF DOMESTIC POLICIES

This section includes a description of three aggregate measures of protection--nominal tariff equivalents, effective rates of protection, and producer subsidy equivalents. A number of studies have been carried out to calculate these aggregate levels of protection. Several of these studies are summarized in Sarko (1986), Lattimore (1982), and Warley (1983).

(i) Nominal Tariff Equivalents (NTEs). An approach used in a number of studies is to convert all trade restraint policies (both tariff and nontariff) to a nominal tariff equivalent. This value is calculated as the ratio of a domestic price to the landed price of a similar product. The nominal tariff equivalent does not include any subsidies paid directly to farmers and hence only accounts for border measures.

NTEs for Canada and the United States have been estimated by several researchers.[1] While these estimates varied, for the 1970s NTEs were zero or quite low in both countries, except for dairy, poultry, and eggs in Canada, and sugar and dairy in the United States. A recent study by Tyers and Anderson for 1980-82 indicates that the weighted average NTEs for all agricultural commodities was 16 percent for United States and 17 percent for Canada, with highest support for dairy at about 100 percent in both countries.

(ii) Effective Rate of Protection. This approach extends the nominal tariff equivalent by taking into account the protection on only the value-added portion of a product. Thus it accounts for government support to inputs as well as outputs. It is defined as the ratio of value added at domestic and international prices. Direct subsidies, however, are not included and getting accurate estimates of value-added portion of output has proved to be difficult.

Estimates of effective rates of protection (ERPs) are substantially larger than NTEs.[2] For Canada, two major studies indicate quite different levels, but both show that dairy, poultry, and eggs are the most protected. For the United States, rice, dairy, and sugar were the most protected commodities.

(iii) Producer/Consumer Subsidy Equivalents (PSE/CSEs). This measure represents the direct subsidy that would be required to replace all support programs and leave farm income/consumer expenditures unchanged (i.e., the dollar value of all transfers by direct and indirect programs). The concept, while straightforward in principle, becomes more arbitrary as decisions on which policies to include, how to apportion non-commodity-specific policies, and what type of accounting rules will be used must be made for its calculation. Quantitative production controls, voluntary export restraints, input cost differences (e.g., feed costs), and exchange rate restrictions and other macroeconomic policies are not easily included.

Producer subsidy equivalents (PSEs) also vary quite considerably among studies done in different years.[3] This reflects not only variations in approach and policies included but also variations in the extent of program supports in each year.

For 1979-81, Organization for Economic Cooperation and Development (OECD) estimates of PSEs are similar in Canada and the United States for wheat and coarse grains, while Canadian levels are higher for dairy, livestock, and poultry but lower for sugar

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1. For Canada, see Harling and Thompson (1983) and Soe Lin (1980). For the United States, see Wipf (1971), Yeats (1976), and Anderson and Hayami (1986).

2. For Canada, see Harling and Thompson (1982) and Soe Lin (1980s). For the United States, see Wipf (1971), Yeats (1976), and Haley (1982).

3. See Food and Agriculture Organization of the United Nations (FAO) (1975 and updates in various years), Lattimore (1982), Josling (1981), OECD (1987), and U.S. Department of Agriculture (1987).

(figure 1). For the commodities studied,[4] Canadian PSEs averaged 23.9 percent and the average U.S. PSEs were 16.0 percent. A U.S. Department of Agriculture (USDA) study estimated that the weighted average aggregate PSEs for both Canada and the United States were 22 percent of farm price for 1982-84 (USDA, 1987). The study found that livestock, barley, and soybean PSEs were similar in both countries, while U.S. support was higher for corn, sugar, and wheat, and Canadian support higher for dairy products and poultry.

The above estimates of PSEs do not include state or provincial government program expenditures. In general, Canadian provincial agricultural programs are more important than U.S. state-level programs because of the differences in federal-regional division of power (see Coffin's paper in this volume). The extent of the differences will vary substantially by commodity, region, and year. In the United States, 1984 state government expenditures for red meats in sixteen northwestern states amounted to 0.3-4.9 cents/lb. carcass weight for beef and 0.1-3.6 cents/lb. carcass weight for hogs, or approximately 2 percent of sales for cattle and 1 percent for hogs (Kerr, Cullen, and Sommerville, 1986). The federal expenditures for red meats in these states were generally smaller than state expenditures. In Canada, estimates of total government expenditures are somewhat higher for red meats than in the United States. Provincial expenditures for hogs accounted for about 3 percent of sales, while federal expenditures also accounted for about 3 percent of sales on average for 1981/82-1985/86. For beef, provincial expenditures were about 8 percent (4 percent excluding Quebec), while federal expenditures are about 1 percent of sales.

## TRADE IMPACTS OF DOMESTIC POLICIES

A number of studies have attempted to estimate the international price and trade impacts of domestic and trade policies by simulating a reduction in these aggregate protection measures, either in a multilateral or unilateral approach.

Three multilateral studies, one by the International Institute for Applied Systems Analysis (IIASA) (Parikh, 1987), one by Tyers and Anderson (1986), and one by the OECD (1987), use a multi-commodity, multi-country approach to simulate reduced aggregate protection. The lower producer support and consumer prices in those studies resulted in lower world production and higher world prices. The extent of the price changes in these studies depended upon the estimated responsiveness of producers and consumers to these reductions in support and the demand/supply substitution among commodities. For countries/commodities that already have a low level of protection, the net effect was higher returns to producers. The relationship among livestock and feedgrains is complex, in that lower livestock numbers reduce feedgrain demand while changing relative protection levels among commodities may cause variations in the mix of livestock/feedgrain trade.

The IIASA and Tyers-Anderson studies used nominal tariff equivalents, while the OECD study used PSE/CSEs. In general, the three studies indicate that if multilateral trade liberalization, including relaxation of quotas, occurs within the OECD (table 1):

- Canada will increase net exports of livestock and dairy and reduce grains and poultry. (Tyers and Anderson suggest more dairy imports and coarse grain exports.)

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[4] Commodities include wheat, coarse grains, rice, dairy products (fluid, butter, cheese, whole milk powder, skim milk powder, condensed milk), beef, pork, poultry, sheepmeat, sugar, rapeseed, soybeans, and wool.

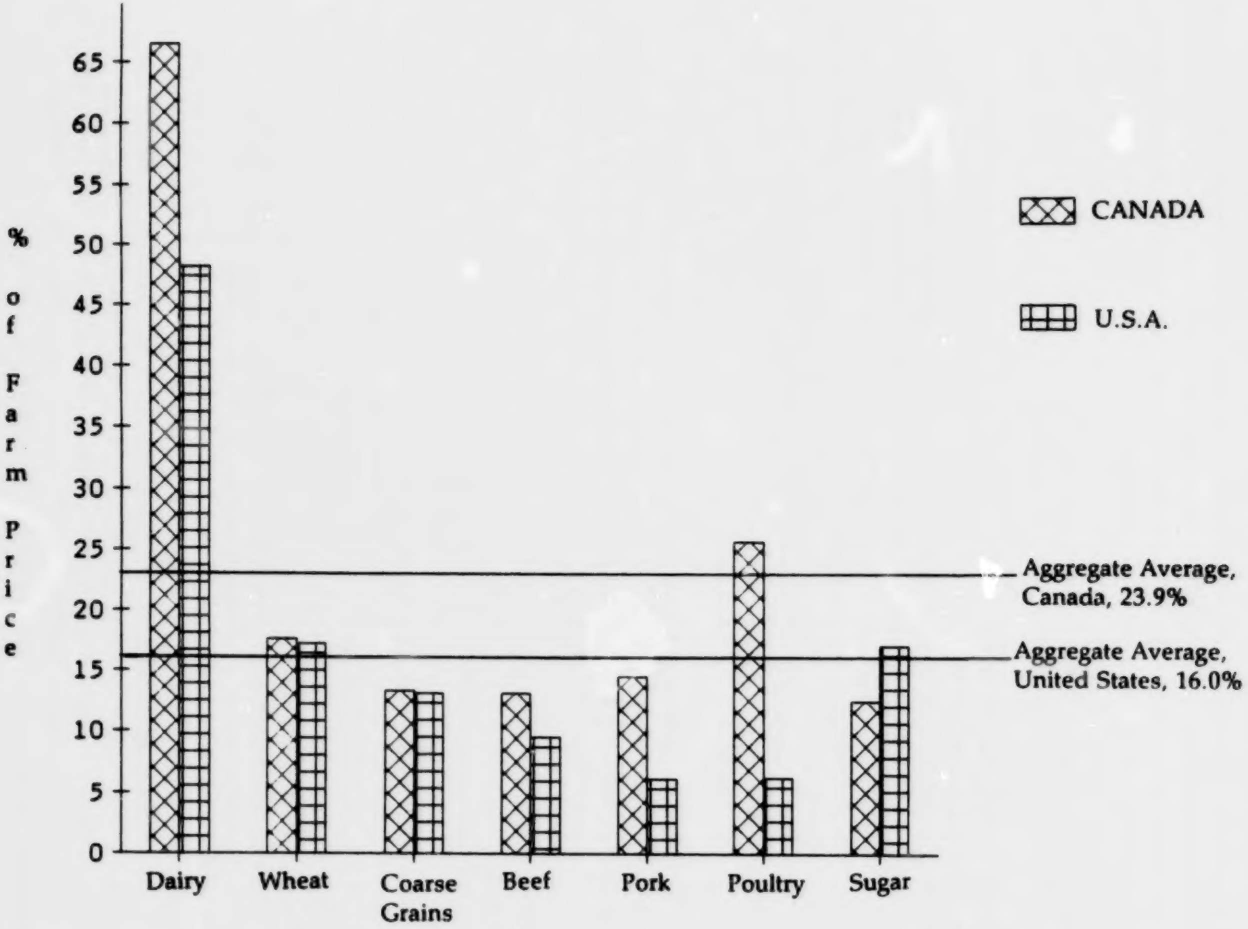

FIGURE 1. Producer subsidy equivalents, Canada and the United States, 1979-81. *Source:* Data from Organization for Economic Cooperation and Development, *National Policies and Agricultural Trade* (1987), annex II, table 2.

- The United States will expand net exports of wheat and feedgrains (partly as a result of relaxation of its set-aside program), livestock, and poultry, and reduce dairy and soybeans. (IIASA indicates that dairy exports will also expand.)

While these results are useful in multilateral context, one cannot easily interpret them for bilateral discussions since absolute and relative price changes could be quite different. In fact reduction of government support (PSEs) in the United States and Canada only would be similar to unilateral action. In this case, world prices would not increase very much, even for those commodities where North America accounts for a sizable proportion of world markets. Other countries with continued assistance would expand production and increase their net exports to North America. For grains and oilseeds, the OECD study indicated that world prices would fall if the United States unilaterally removed both assistance and production controls, because the impact of production controls outweighs the impact of government payments.

TABLE 1. Change in U.S. and Canadian Net Global Trade and World Price from OECD Trade Liberalization Scenario[a]

| | Canada | United States | World price |
|---|---|---|---|
| | (million US$) | | (%) |
| Milk | 8.9 | 74.8[b] | 4.4 |
| Beef | 22.5 | -310.0 | 1.5 |
| Wheat | -41.0 | 87.9 | -0.1 |
| Coarse Grains | -16.6 | 50.2 | -0.3 |
| Soybeans | 0.3* | -225.2 | -1.0 |
| Pork | 1.0 | -7.7[b] | 0.3 |
| Poultry | 3.9* | 24.9 | 0.3 |

*Source*: Adapted from OECD, *National Policies and Agricultural Trade* (1987), annex IV, table 14.

[a] Scenario of a 10 percent reduction in PSEs and CSEs for all OECD countries.

[b] Importer in 1979-81.

A major limitation of these studies is the degree to which these aggregate protection measures accurately reflect the trade impacts. Different policies may have similar levels of protection but have quite different trade distorting effects. For example, the Canadian dairy and poultry industries have a very high level of protection as estimated by PSEs and CSEs. However, because of the supply control features of these programs, it is anticipated that there would be little change in net trade if that protection was reduced. To measure more accurately the trade impacts of reducing protection it is necessary to examine specific policies or types of policies--that is, (i) those that are production neutral (a pure transfer), (ii) those that directly affect production (i.e., are equivalent to a dollar received in the market place), and (iii) those that involve quantitative restrictions on supply. Each of these types of policies have quite different trade impacts for a similar level of aggregate support.

Horticultural commodities, generally, have not been included in these aggregate protection measures. Much of the protection in Canada for this sector is in the form of tariffs, which may vary by season and region. Many fall within a 10-15 percent range (including some with a specific and minimum percentage), and overall average tariff level is estimated at about 9 percent. Since with liberalization Canada would likely increase some exports to the United States (e.g., potatoes, mushrooms, small fruits, storable vegetables) and in some other cases there would be little change, the average price decline is likely to be small and hence the average decrease in production would also be very modest. Nevertheless, there could be much higher declines for products such as salad vegetables and fruits. While the overall revenue impact for the horticultural sector would be small, certain segments and regions would be more adversely affected than others. Nevertheless, exchange rate variation during the past year has been about as important as the average level of horticulture tariffs.

## OTHER POLICY CONSIDERATIONS

The aggregate analyses of trade effects from liberalizing domestic agricultural programs ignore some specific implementation and protection aspects of trade and domestic policies that are not easily measured. In this section, four such dimensions will be examined: quality assurance, income stabilization, supply management, and regional concerns.

### Quality Assurance Issues

Health and sanitary and disease control regulations on imports to both countries are designed to protect consumers and producers from foreign diseases. Grades and standards are designed to identify and classify important characteristics to facilitate transactions for market participants. To the extent that these measures currently restrain trade, they would be included in the aggregate protection measures. These measures must, however, be considered quite differently from other support policies. Canada would be reluctant to relax any livestock health regulations because of the potentially high economic cost to producers from the introduction of such beef-cattle diseases as brucellosis, tuberculosis, bluetongue, and anaplasmosis and such pork diseases as pseudorabies. This cost would include the loss of benefits that Canada gains from the sale of breeding stock, semen and embryos in third country markets as a result of its current health standards. These costs, which would be incurred if health standards were lowered, are not measured in the estimated impact of the reduction of aggregate protection.[5] Nevertheless variability in these regulations and their interpretation suggest that these measures are sometimes misused to impede imports (see paper by Prentice and Menzie in this volume).

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5. It has been estimated by O'Riordan (1979) that introduction of brucellosis to Canada would eliminate exports of breeding and other livestock with a discounted present value of $81 million (in 1985 dollars), increase human disease (undulant fever) treatment costs by $68 million, decrease the calf crop, and increase slaughter of infected animals.

Maintenance of Canadian grade standards is also an important issue for commodities such as wheat and livestock. Canadian hard red spring wheats obtain a price premium because of their high quality. The grading system for wheat is based on visual inspection, and the "contamination" of the system from imports would reduce domestic and export price premiums. The Canadian livestock grading system is designed to encourage production of leaner carcasses than in the United States. Harmonization of these grading systems may involve losses beyond those considered in aggregate measurements.

### Income Stabilization

Governments in both countries operate a number of programs designed to improve the stability of producer incomes (as well as prices and production). In some cases, these programs not only include stabilization objectives, but income support as well. It may be politically impossible to eliminate all stabilization programs. The question, then, is how to modify these programs so that they provide stability for farm incomes but do not provide encouragement to production and exports (the "decoupling" argument). In this case, the aggregate protection measure may remain significant, but its trade impact may be insignificant.

One of the major current trade issues relates to livestock stabilization policies. Canada operates stabilization programs for livestock but the United States does not. Hence, there is currently a countervailing duty on Canadian hog exports to the United States to offset government expenditures in this sector, mainly stabilization payments. A recent study shows that the countervail more than offsets the stabilization payment (Gilson and St. Louis, 1986). As a result, pork producers are worse off than if neither program were in place (i.e., federal and provincial stabilization programs and the countervail duty). Canada has recently imposed a countervail duty on imports of U.S. corn. The impact of this duty is minor as only a small volume of corn is traded. From these two examples, it is obvious that both countries need to agree on what are appropriate stabilization programs to avoid the need to resort to countervailing duties.

### Supply Control

Both countries operate various types of supply control programs for major sectors of the agricultural economy. For the United States, the grains sector and, recently, the dairy sector have some form of supply control. Participation is voluntary in these programs but producer benefits are generally set to achieve a specific production reduction target. In Canada, the dairy and poultry sectors are under mandatory supply management. These types of programs are not well suited for an analysis of their trade impacts using aggregate protection measures illustrated above.

The critical issue relating to supply control programs is their net impact on trade. While only limited work has been done on these programs in both countries, the general view is that the trade impacts of these programs are minor and net overall effects may be a reduction in trade.[6] Hence the trade impacts would be substantially less than implied by tariff equivalents or PSEs. Prior to the introduction of national supply management programs for turkey and chicken in Canada, there was very limited net trade between Canada and the United States. Liberalizing trade nevertheless would have a very dramatic

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6. Barichello (1986) estimated that marginal costs for eggs in Canadian and U.S. northern states were comparable in 1980.

effect on these industries. For Canadian dairy and poultry producers, prices would be much lower, resulting in large capital losses due to reduced production quota values and land and building values. As well, without regional quotas in Canada there may be considerable rationalization of production closer to population centers with processing plant consolidation and integration of processors into the production sector.

Clearly these dramatic effects, for minor gains in trade, indicate that governments will have difficulty reaching an agreement to change the basic supply control programs in both countries. Governments may wish to consider additional controls on production rather than institute price reductions as a means of meeting mutually acceptable lower support levels for commodities already under supply control.

### Regional Concerns

In Canada, the provinces have had an important shared role with the federal government in agricultural policy, both historically and constitutionally. A U.S.-Canada trade arrangement would likely require the elimination of some inter-provincial restrictions in Canada, causing some rationalization in regional production shares. This would be of concern both from the point of view of regional development and in terms of trade patterns.

Agriculture plays an important role in regional development policy and programs, which provides the rationale for allocating regional production shares, regional commodity production incentives, transportation subsidies, and so forth. As in the case of stabilization, it would be important to agree on appropriate programs to promote regional development without giving an incentive to increase national production and net exports.

Regional differences are also important in measuring the trade impacts of domestic policies. Under an enhanced trade arrangement, more north-south trade would likely replace east-west trade. As a result, the trade impacts would probably vary by region. For example, more Canadian potatoes may be exported from the Maritimes, but more U.S. potatoes imported into western Canada. Similarly, eastern Canada may import more feeder cattle to be balanced by more exports from western Canada and west-east movement of cattle and beef within Canada would be reduced.

## SUMMARY AND CONCLUSIONS

Recent studies have greatly expanded our knowledge and understanding of domestic agricultural policies and their impact on trade. The development of the comprehensive producer and consumer subsidy equivalents has provided a better yardstick for measuring total assistance received by agricultural producers. In addition to those policies that are reflected in the PSEs, there are a number of additional policies that are not easily incorporated in this framework. These include quality assurance and quantity restraints.

Estimates of the level of protection using PSEs for Canadian and U.S. agriculture in 1979-81 indicated that approximately one-fifth of producers' income was generated from government programs. Dairy products were highly supported in both countries, as was sugar in the United States.

Despite this high level of support, estimates from several studies have shown that the impact on U.S.-Canadian trade of reduced support would be relatively small, if the reduction occurred on a multilateral basis for all OECD countries. This is in part because the lower support to producers would be partially offset by higher world prices. If, however, only the North American countries liberalized trade, a small increase in the world price would be observed and third-country producers would benefit most from expanded trade.

Canada and the United States would have particular difficulties in adjusting domestic policies bilaterally without establishing a common external protection against third country markets.

Despite relatively small overall impacts of liberalizing trade, certain commodity groups and regions could be quite adversely affected. Processed products could face more adjustment than fresh commodities, as the quantities demanded and supplied are more responsive to price changes and the level of protection is generally higher.

Both countries maintain certain quality assurance programs to protect health and safety and to indicate quality standards. For Canada, these often enable Canadian products to obtain domestic and export price premiums for high-quality products. Limited analysis has been done to assess the cost, uncertainty and risks associated with harmonizing these regulatory programs.

Given the inherent instability of the agricultural sector, stabilizing producers' incomes will likely remain a high government priority. If so, both countries need to develop income stabilization policies and programs that are recognized internationally as causing only minimum trade distortions (e.g., pure income transfers).

Supply control programs are used in both countries to provide income stability, as well as for income enhancement and regional development. The Canadian dairy and poultry industries are notable examples. These programs generate high PSEs but have a limited impact on trade. Nevertheless, current producers would suffer large losses in asset values if these programs were discontinued.

In trade negotiations, quantitative controls may be considered as an alternative to lower support prices to provide the same reduction in government assistance for those commodities already under some form of supply management.

Considerable work remains to be done to improve the measurement of the effects of agricultural policies on trade. Of the approaches currently used, the producer subsidy equivalent is more comprehensive than nominal tariff equivalents or effective rate of protection. However, relating these aggregate measures to trade effects can provide distorted results since different policy measures with similar protection can have quite different trade impacts. Further work is required to segment policies into (i) pure transfers, (ii) producer support measures, and (iii) quantitative restrictions, and to derive the differential trade effects among these different policies.

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# SPECIFIC COMMODITY PERSPECTIVES: ANIMALS AND ANIMAL PRODUCTS PANEL

### A SUMMARY OF PRESENTATIONS AND DISCUSSION

### Katie Macmillan, Rapporteur

The animals and products panel consisted of representatives from the poultry, livestock and meat, and dairy industries. The issues discussed in the panel session are best examined under those three headings.

## POULTRY

Arne Mykle, a chicken producer and past chairman of the Canadian Chicken Marketing Agency, argued for the retention of the supply management system for the Canadian poultry sector. Under the existing structure, domestic supplies of chicken, turkeys, and eggs are controlled through the allocation of production quotas and the restriction of imports to a small percentage of domestic production. The result is higher poultry and egg prices in Canada than exist in the United States, where competition is stiffer and costs lower.

Mr. Mykle saw little sense in eliminating marketing boards at a time of excess food supply worldwide. He pointed out that supply management results in acceptable producer incomes, without requiring government subsidies. While consumers incur the cost of this support, they are ensured in return much more price stability than would occur under a free market environment.

The consumer costs and benefits of supply management generated some debate in the discussion session. Mr. Mykle pointed to rising Canadian poultry consumption, steadily increasing imports from the United States, and price increases at a rate lower than the Consumer Price Index for food in recent years. Critics of the system argued, on the other hand, that increases in Canadian poultry consumption have lagged behind consumption growth in the United States, which suggests that supply management does have some impact on market conditions.

A concern of the Canadian poultry industry is the phenomenal market growth that has occurred in recent years for processed poultry products (the so-called "near-chicken" products) such as poultry pot pies, chicken cordon-bleu, and chicken kiev. These items do not receive protection under the marketing board system and are not included on the import control list. They are, however, protected by tariffs. Mr. Mykle predicted serious consequences for producers and processors if tariffs on near-poultry products were reduced under a free trade agreement, without adding them to the list of items eligible for import control. Small-scale production and expansive geography hinder Canadian competitiveness in these products.

The Canadian poultry industry opposes any weakening of supply management boards. Mr. Mykle offered two approaches for dealing with the poultry subsector under a Canada-U.S. free trade agreement. The first would entail tariff reductions for poultry items currently under supply management, but the maintenance of existing import quotas for these products. In addition, tariffs would be retained for exempted items, namely near-poultry products. His second proposal would involve gradual reductions in all tariffs but the addition of processed poultry products to the import control list.

The discussion that followed Mr. Mykle's presentation focused on the merits of the marketing board system. While it cannot be faulted for contributing to world oversupply problems, it does result in substantially increased asset values for producer-participants at the expense of consumers of the managed products.

## LIVESTOCK AND MEAT

Dave Adams of the Canadian Meat Council and Richard Pasco of the U.S. National Pork Producers Council spoke of trade issues in their industry. Few barriers exist in the trade of cattle, beef, hogs, and pork between the United States and Canada, suggesting that livestock and meats are more amenable to trade liberalization than many other sectors within agriculture. The trade impediments that do exist are primarily in the areas of technical barriers, sanitary rules, and animal health regulations.

A priority for the Canadian industry is some mechanism for the resolution of trade disputes. In Mr. Adams' view, the principal problem facing Canadian livestock and meat products is unilateral decisions by U.S. interests on what constitutes unfair trade. Mr. Pasco predicted that the U.S. industry would strongly resist any trade arrangement that restricted its ability to deal with unfair trading practices by foreign competitors.

The group discussion addressed barriers to trade in the meat and livestock sectors. A number of hidden barriers on both sides of the border were pointed out, including low feed-grain costs for U.S. producers and price stabilization programs in Canada.

## DAIRY PRODUCTS

Paul Christ of Land O'Lakes, a major U.S. dairy cooperative, outlined the vastly different marketing structures governing dairy production in the two countries. Very simply, the focus of regulation in the U.S. system is the price of milk, with the result that supply is the variable factor. In Canada, milk supply is strictly administered through production quotas, and prices are left to vary.

Mr. Christ characterized the U.S. industry as mildly opposed to a free trade arrangement with Canada. Dairying was portrayed as the only agricultural sector in the United States in which substantial concessions could be made, and Mr. Christ expressed concern that U.S. interests would be traded away in negotiations to achieve an overall deal. While the possibility of increased imports from Canada poses little threat to U.S. dairy producers as long as both countries keep their existing support programs, an agreement with Canada to relax import restrictions could lead to calls for similar access from milk producers in other countries.

Mr. Christ was pessimistic, however, that any success would be achieved in harmonizing dairy policies, citing the substantial differences in the two dairy systems and the strong support for the status quo by both Canadian and U.S. producers.

In group discussion that followed, two polar proposals for freer trade in dairy products were debated. The first would involve the abolition of existing policy structures in the two countries and the establishment of both a common external tariff and a North American price for milk. This option would mean the end of supply management for dairy products in Canada.

Under the second proposal, the border would be opened through the relaxation of Canadian milk import quotas, but the power of Canadian milk marketing boards would remain intact. The result would be increased milk imports into Canada, particularly imports of manufactured milk products, where U.S. prices are significantly lower. Canadian milk producers would be forced to cut back on output and incur the costs of disposing of excess milk powder.

Discussion also centered on the current massive U.S. milk surplus. There was a call for greater coordination of milk demand and supply in world markets.

## CONCLUDING POINTS

Two factions emerged from this session: the cattle and hogs group, where the possibility of policy harmonization looks a little more promising, and the dairy and poultry group, where the prospects for harmonization look rather bleak.

In the cattle and hogs group, although there remain some sources of friction, such as defining subsidies and determining what constitutes a level playing field, there seems to be a general view that free trade, provided it is fair trade, is both desirable and probably achievable between the United States and Canada.

In the dairy and poultry group, no such consensus exists. Both dairy subsectors have some government intervention, but the mechanisms differ between the two countries. To harmonize the policies across the border would require one or the other (or both) giving up their program entirely--a most unlikely occurrence. There is little direct government intervention in the U.S. poultry subsector, although there is a considerable degree of vertical integration. By contrast, the Canadian poultry industries are subject to supply management. Here again, as in the dairy subsectors, harmonizing the policies would impose considerable hardship on one or the other country (or both). Resolution of these differences does not appear to be imminent.

# SPECIFIC COMMODITY PERSPECTIVES: PLANTS AND PLANT PRODUCTS PANEL

### A SUMMARY OF PRESENTATIONS AND DISCUSSION

**Kristen Allen, Rapporteur**

The plants and plant products panel consisted of representatives from the grains, horticultural products, beer, and wine subsectors. The panelists were asked to discuss the opportunities, challenges, and problems their subsectors might face in a U.S.-Canada free trade agreement.

## GRAINS

Ted Turner, from the Canadian Wheat Board, began the session by giving the Canadian grain perspective. His first observation was that, largely as a result of trade-distorting policies, consumers throughout the world are getting a bargain on many grain products, and that producers and taxpayers are footing the bill.

The United States and Canada have relatively little bilateral trade in cereals. The greatest opportunity for both countries is in improved world trading arrangements. At present, Canadian grain producers feel that they have been caught in the battle between the United States and the European Community, and they are caught at a disadvantage as they lack any mechanism that would help them retaliate.

Both countries have similar goals in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), and Canada, therefore, applauds the U.S. proposal to the GATT calling for an end to agricultural subsidies over a ten-year period. In response to a question, Mr. Turner suggested that even if this goal were to prove not to be fully achievable within the stated time, both countries should, nevertheless, move in that direction. However, he argued, despite almost any movement toward free trade, Canadian farmers would insist on keeping the Canadian Wheat Board as a marketing agency. He pointed out that large government payouts under CWB programs are rare, that producers cover a portion of the costs, and that the Board's practices are not trade-distorting. He drew a parallel between the pricing policies of the CWB and those of the large grain-trading companies, offering the view that if the U.S. government did not announce the loan rates for supported commodities (which have generally been close to the market prices) it is unlikely that the major grain trading companies would publicize their buying and selling prices.

## HORTICULTURAL PRODUCTS

Dan Demster, from the Canadian Horticultural Council, spoke about issues that concern producers of fruits, vegetables, and nursery products. He noted that over the past twenty years Canada has been importing increasing amounts of fruit and vegetable products. This growth in imports has accompanied increases in per capita purchases of fresh fruit and vegetables. The United States has been the major beneficiary of this expanding trade, but about 37 percent of the total does come from other countries, mainly from the tropics.

Canada uses a number of trade barriers to protect its horticultural industries and to promote orderly marketing. The barriers include tariffs, phytosanitary restrictions, pesticide regulations, and trade relief mechanisms. Both countries use tariffs: Canada primarily against imports from the United States, the United States primarily against imports from Mexico. In Mr. Demster's view tariffs may be the most difficult area to harmonize in a bilateral agreement--he suggested that it may be necessary to look toward reducing tariffs for North America as a whole (the United States, Canada, and Mexico).

The Canadian Horticultural Council would like to see some improvement in the U.S.-Canadian trading relationship, but they have a number of concerns about such a move. They are particularly concerned about making "a great leap forward" toward more competition and finding that they are leaping alone. They are concerned also about the possibility of changes in Canada's consignment-selling and container legislation. Among the specific issues they would like to see addressed in a Canada-U.S. free trade agreement are: harmonizing the procedures for pesticide registration and standardizing residue tests and standards; harmonizing injury criteria and trade relief procedures; and reviewing the subsidy issue, in particular defining subsidies (although they recognize that this issue may be more appropriately addressed in the multilateral negotiations).

During the general discussion Mr. Demster agreed that one of the things that the Canadian horticultural industry needs to do is to improve the quality of its products. But he went on to note that improving product quality alone will not solve all the industry's problems. The issue of subsidies must be addressed, because until it is the Canadian industry will have to compete against other countries' treasuries, which puts it at a disadvantage.

## BEER

Howard Collins of the Brewers Association of Canada made probably the strongest plea against freer trade between the United States and Canada. He said that the prospect of unfettered trade between the two countries held little joy for the Canadian brewing industry.

Government incentives designed to encourage regional development, rather than an open competitive environment, dictated the structure of the Canadian brewing industry. The result was an industry that consists of a number of small breweries in each province, in total more than fifty, each about one-fourth the average size of breweries in the United States, and no single plant having a market share larger than 3 percent. In contrast, the largest U.S. plant has a market share of about 9 percent. Free trade would throw the tiny, provincial Canadian plants into competition both with large, national breweries in the United States and with each other. (At present there are barriers to interprovincial beer sales in Canada.) One of the U.S. plants, the Coors plant in Golden, Colorado, is so large that it alone could produce 75 percent of Canada's annual beer demand. Total U.S. plant capacity could meet Canadian demand about three times over.

In Mr. Collins' opinion there would be no way that the Canadian industry could match the economies of size that are realized by U.S. plants. Free trade in beer would cause Canadian breweries to lose about one-third of their domestic market to U.S. companies (up from about 18 percent now), resulting in the loss of about 8,000 jobs directly associated with the Canadian brewing industry, and the industry as a whole becoming a series of small regional breweries. When a member of the audience suggested that would be little change from the current structure, Mr. Collins agreed, but said that Canadian breweries would have a smaller share of the total market under free trade.

## WINE

In marked contrast to the Canadian beer industry, U.S. wine producers take a positive view of freer trade between the United States and Canada. James Clawson of the Clawson Company, a Washington D.C.-based wine industry consulting firm, said that the U.S. wine industry is interested not in taking over the Canadian wine market, but in sharing the North American market with the Canadian industry and having joint preferential treatment in that market over the wines of third countries. At present U.S. wines have a considerably smaller share of the Canadian market than do European wines.

U.S. wine producers have, according to Mr. Clawson, tried hard to penetrate the Canadian market, but have continually run into the problem of provincial control of wine marketing. The U.S. industry has quite clear goals in a free trade agreement between the two countries: greater access for U.S. wines to the Canadian market, by requiring the provincial Liquor Control Boards to be more open about their reasons for carrying or not carrying certain wines, and pushing for them to carry more U.S. wines; and elimination of the discriminatory markups of U.S. wines, which make them considerably more expensive than other wines sold in Canada. At present, Mr. Clawson pointed out, U.S. wines account for a smaller share of Canada's wine market than Canadian beer has of the U.S. beer market.

## GENERAL DISCUSSION

During the general discussion several notable points were made. One was that while most groups express support for a U.S.-Canada free trade agreement in general, when the same groups examine the details they frequently raise objections to certain aspects that will affect their particular industry or producer group. The problem becomes more complex with greater degrees of processing. For example, the Canadian beer industry is concerned about having to compete with U.S. brewers in a freer trading environment, but at the same time they might also have access to lower-cost inputs, which would increase their competitiveness.

The other important point raised was that of market niches. With the relatively large number of affluent consumers in the United States and Canada, many specialty products can find a lucrative market among a small segment of the population. A more open border could increase the size of that segment. Beer again served to highlight this point. Some members of the audience voiced their preference for Canadian beers, deploring the decline in small, regional, and local breweries in the United States. The audience suggested that freer bilateral trade could expand the market for Canadian regional beers so that rather than being swamped by mass-produced U.S. beer the Canadian breweries might do quite well by targeting a small, well-heeled segment of the North American population. No attempt was made to reach a consensus on the issues discussed in this session.

# NORTH AMERICAN AGRICULTURE IN AN INTERDEPENDENT WORLD: CHALLENGES AND OPPORTUNITIES

## Charles Mayer

Thank you very much for the opportunity to address you this evening.

Madame Chairman, in your opening remarks, you talked about comedy, satire, and tragedy. The situation we face in agriculture is perhaps a little bit of each of these. It is a serious situation, and one of the ways we are going to get through it is to keep a sense of humor. But there is really nothing comic about it. Because it is such a serious situation, you could say that, in some ways, it has an element of satire. There is also a certain irony, and I will try to touch on some of those ironies later on. Above all, however, as many here know, it is a tragedy.

I should mention that I have some hands-on experience as far as farming goes. Like me, however, many farmers these days have to get an off-farm job to stay farming.

The topic that I was asked to speak on tonight gives me a fair amount of latitude.

I guess one of the things that strikes me is the question: why are we here? We are here because we have problems, and they are large. One hopes that meetings like this will help to create the determination and ideas to address some of these problems. But, at least in my view as a farmer, I really wonder if we fully understand the extent of the problems.

Take North America, which is a very productive part of the world. Canada and the United States have many things in common. We produce agricultural products in the northern hemisphere; we both have advanced production techniques; we use the same machinery, the same farm chemicals, and similar agricultural practices. But above all, we both need to trade. Canada is more dependent on trade, especially where grains and oilseeds products are concerned, than is the United States. As much as 80 percent of the wheat that Canada grows is exported. In the United States, the figure is close to 50 percent, largely because the Americans have a much larger domestic market to service. Because we are both so dependent on trade, we need some predictable trade rules in the world if we are going to survive.

At the same time, there are differences between our two countries. In the United States, one finds winter varieties of wheat for the most part, which means less variation in yield than we would have in Canada. For example, in 1986, the quantity of acres seeded in Canada was not very different than in 1985. Yet there was a 25 percent increase in production, which was almost totally attributable to weather. You do not get such variation in the United States because more winter varieties are planted there.

Canada also has a different system of selling. We use the Canadian Wheat Board as a selling agent for wheat, oats, and barley sold in the export market. I would like to try to clear up some misconceptions about the Board.

The Board is simply a selling agency on behalf of Western Canadian grain producers. It does not go into the market and set supply. It regulates the marketing of grain throughout the crop year in order to give producers an even-handed opportunity to deliver.

It also operates a pooling system so that no matter when grain is delivered throughout the crop year, farmers get the same price.

I think there are also some misconceptions generally about Canadian agriculture.

First, in my view, Canada is just as efficient as the United States. In fact, a study in 1982 by the Office of Technological Assessment of the U.S. Congress pointed out that the average Saskatchewan farmer is as efficient as the most efficient Kansas farmer. I am not going to stand in front of an international audience and say that Canada produces the best grain in the world or that we have the best grading system. But I do not know of any that are better.

Second, in the past, Canada has not stepped in and attempted to take advantage of markets from which the United States has backed away.

The other thing that needs to be said in an international forum like this is that we are both very dependent on each other: agricultural trade between our two countries is worth about Can$7 billion. The United States has the advantage--running a surplus with us in the area of a half billion to a billion Canadian dollars a year. Now, that is fairly significant when you think that Canada is one-tenth the size of the United States.

In overall trade terms, Canada is the fastest-growing market the United States has outside of the U.S. market itself. In terms of trade, we are more important to the United States than is Japan. I do not think many people realize that.

This brings me to some of the concerns that many of us have about where we are going in agricultural trade. It seems ironic to me that the European Community and the United States, because of the size of their domestic markets, are much better able than Canada, Argentina, or Australia to shield their producers from the realities of world grain markets, yet these two areas are the ones that have increased their production most dramatically.

Since 1969, Canada's wheat production has gone up by approximately 35 percent. The increase in the United States has been in the area of 55 percent. In actual numbers it is even larger, because the United States starts from a much bigger production base. At the same time, European production has increased by approximately 94 percent, again starting from a much larger base.

These production increases, in our view, have not been accomplished by any real comparative advantage. They have been accomplished, especially in the case of Europe, with some very large subsidies that have nothing to do with comparative advantage.

Yet, if you look at the political systems of the five major wheat-exporting areas, while all are adept at making policy decisions, only three--Canada, Argentina, and Australia--are better able to make policy changes than either the United States or the European Community.

In the United States, the secretary of agriculture may be in agreement with the president, but there are two houses of Congress to deal with before change can occur. Similarly, it was difficult enough to obtain consensus among the members of the European Community when there were only six of them; that degree of difficulty increased when the Community expanded to nine members and then to twelve.

Ironically, the countries that are being damaged the most by this trade war are, because of their political systems, best able to take direct political action.

Therefore, Canada certainly supports and welcomes U.S. efforts to address the overall trade problems in agriculture. When the Americans opened their initiatives in the General Agreement on Tariffs and Trade (GATT) a couple of weeks ago, they talked about eliminating all agricultural subsidies by the year 2000.

Canada is concerned by some of the reactions to this proposal; we see resistance in Japan, in Europe, and even in some parts of the United States. This resistance surprises me, considering that the Americans are talking essentially about a 10 percent reduction each year for ten years. And it causes us great concern when the areas of the world that are causing the problems are reluctant even to talk about solutions.

Let me tell you about the reality in Canada. I will give you an example from my own farm. Two years ago, we wanted to sell some feed wheat at the end of the crop year. We phoned around and got the best price we could. A feed company came into the yard and picked up the wheat for $4.05 a bushel. That same feed wheat would sell today for about $2 a bushel--a 50 percent reduction in just two years.

Last year, taking average yields from across the three prairie provinces and calculating variable costs, farmers ended up getting back only their variable costs. This means that there was no return on capital assets.

My guess is that the Canadian Wheat Board's initial prices this year will return to farmers a fraction--probably 60-70 percent--of variable costs. The situation is basically the same in Argentina and Australia.

What does this tell you about the shape this industry is in? We have an industry that is essentially going out of business.

Let us turn for a moment to Argentina--a country very dependent on agricultural trade to generate income to repay its massive foreign debt. In the past year, Argentina has lost a big percentage of its foreign exchange earnings largely as a result of declining grain prices. In other words, it has debt repayment problems that are being caused by the subsidy war.

What has happened here? The World Bank and the International Monetary Fund assist countries with the rescheduling of their debt. But who finances the World Bank? The Americans and the Europeans. Who is causing the problems in the world grain market? The Americans and the Europeans. Clearly, we need some international trading rules in grains and oilseeds. I think there is room for some optimism because some progress is being made through the GATT.

Canada's prime minister has taken the initiative in some of these areas, and our efforts have shown results. A year ago, we would not have been as optimistic about progress through the GATT as we are today. But the process takes time, because over ninety countries are involved.

Domestically, Canada has pursued two other deliberate policies. We will likely increase our market share of world wheat exports this year, and we are probably going to have record grain exports.

When prices are down, you do anything you can to sell. Cash flow is volume times price. Canada has been reasonably successful, and we think we can continue to be successful in terms of quality and reliability of supply.

The third thing we have done as a government is to provide some direct cash injection into the farm economy. Our capacity to do that is limited, however, because we rely on exports for a bigger percentage of our earned farm income than do the Americans or the Europeans. Our domestic market possibilities also are very limited. There is not a lot of potential development except in the service or specialty areas.

This brings me to another point I would like to make. I do not believe that, collectively, exporters have done enough work on the demand side. There are more hungry and malnourished people now than there were ten years ago when the World Food Council was established. And yet we have surplus stocks! We do not talk about marketing, we talk about disposal of surplus stocks, we talk about destroying capacity to produce. As a result, we have witnessed a mammoth misallocation of resources--perhaps comparable to the building of the pyramids. But instead of building pyramids that are durable, we are building them out of the most perishable and the most precious commodity of all--food.

What, collectively, are we doing?

Governments need some genuine ideas from industry and from the academic community. We do not need any ideas on how to spend money, we do that very well.

Another irony in agricultural trade is the situation with Japan and West Germany. Japan is running a massive balance of payments surplus at about Can$70 billion, while West Germany has a Can$8-9 billion balance of payments surplus this year. Incredible amounts of money are generated through trade. Yet they shut out trade in agricultural products with concrete abutments. They shut us right out.

H. L. Mencken, one of the great American journalists, once observed: "There's always an easy solution to every human problem--neat, plausible, and wrong." That is not a bad way to characterize what is going on in agricultural subsidies. Neat, because they are simple to do and they are visible; plausible, because in the short run you may get some results--but dead wrong.

Canada would like to see an end to these foolish protectionist programs that fly in the face of comparative advantage and that deny the interdependence of the world economy. The Americans, to their credit, have long recognized the interdependence of world markets.

A Canadian, Marshall McLuhan, once said that we live in a global village. Well, we live in a hungry global village. If we are going to be able to deal with it, we have to do it recognizing our dependence on each other. It is evident that policies that fail to take interdependence into account will not work in the long run.

We all depend on each other, especially in agricultural trade. If, in setting policies, governments give consideration to the need to benefit other countries as well as their own, the new rules for trade in agriculture will contribute to a more stable future for everyone.

Let me just close by saying that, as a politician, this situation is frustrating; as a farmer, it is frightening.

All kinds of questions come to me as both a farmer and a politician.

Why should Japan and Europe be protected as much as they are from the world market when we see them as being the main culprits?

Do we know for sure that the Export Enhancement Program in the United States, or the restitution program in the European Community, is really being run for the benefit of producers? Or are these programs simply being used by the industry for its own good?

For example, the international selling houses quote figures to the European Community that they say are a representative sample of what the market is and, therefore, they need x amount in restitution payments to meet that market. But how do we know that these figures are accurate?

Why am I not allowed, even though I am efficient as a Canadian farmer, to compete against other farmers on a level playing field or a level barley, corn, or soya bean field, as opposed to competing against other countries' treasuries?

The problem of agricultural trade has now become so large that it has wide implications. It even has a moral connotation, when you consider all the people that need to be fed in the world.

These are some of the questions that need to be asked and to which we must seek a collective answer.

Thank you for your kind attention.

# FORMAL AND INFORMAL NONTARIFF BARRIERS TO AGRICULTURAL TRADE BETWEEN THE UNITED STATES AND CANADA

## Barry E. Prentice and Elmer L. Menzie

Growth of Canada-U.S. trade has been facilitated by geographic proximity as well as by language and cultural similarities. While a relatively free flow of goods and services exists between the two countries, there are significant concerns about the future of this trade. The United States has been facing a growing adverse balance of trade internationally, a part of which is with Canada. Pressures have been building in the United States to reduce the negative balance, and there have been increasing demands by industry groups for protection against import competition. Many of these requests are directed against Canadian products, and in some instances, such as with the import of hogs and softwood lumber, special protective measures have been imposed.

Although tariff reductions would enhance trade, it is evident that the primary concern on both sides of the border is nontariff barriers. Nontariff barriers can be broadly defined as any government regulation, subsidy, or tax measure that directly or indirectly limits imports. This definition may be refined by classifying nontariff barriers as either formal or informal. Formal nontariff barriers are direct actions taken by governments for the intended purpose of limiting imports, while informal nontariff barriers are actions that serve to limit imports as a secondary or indirect consequence of their supposed purpose.

Most formal nontariff barriers have been spawned by domestic programs and regulations, which are not directly trade related. For example, both countries employ import quotas in conjunction with domestic price/income support programs. Without effective border controls, these agricultural programs would be undermined and/or their budgetary costs increased substantially. A similar motive could be attributed to licensing powers that have been granted to quasi-government authorities, such as producer marketing agencies. In general, formal nontariff barriers are readily identified and operate in compliance with (or exemption from) existing international trade law.

Quantitative restrictions are the main type of formal nontariff barriers, but safeguard measures, government procurement policies, and blending requirements can be considered under this classification. Safeguard measures are imposed like tariffs, but are justified as a means of offsetting unfair trade practices, or preventing a temporary market disequilibrium from harming a domestic industry. Federal, provincial, and state government buying practices limit trade by granting explicit preferences to local goods. These preferences may range from allowing a percentage differential in prices of local and imported products to an absolute prohibition of nondomestic supply sources. Also government control and regulation of distribution can provide a significant distortion in product availabilities through special taxes, markups, and sales practices.

The majority of informal nontariff barriers do not limit imports directly but do give a competitive advantage to domestic producers. For example, governments may provide infrastructure such as transportation or irrigation without charging full cost to users and may subsidize the cost of production inputs such as credit, fertilizer, and the like. To the extent that these measures assist domestic production to displace imported products, they act as informal nontariff barriers.

Regulations governing packaging, labeling, quality, and health may also serve to restrict trade. Exporters may be forced to incur additional costs to satisfy regulations for packages and containers for exported products which often do not conform with those used in the domestic market. For example, language or certain nutritional or other information may be required on product labels in one market but not in the other. These requirements all add to the costs of imports and may cause a reduction in trade.

Plant and animal health regulations normally are employed as necessary industry safeguards and not to limit competition. In some cases, however, health regulations place burdensome inspection and quarantine costs on imports and thereby essentially prohibit trade. There are also documented cases in which health regulations have been used deliberately as a nontariff barrier to trade.

The remainder of this paper concentrates on the type and scope of formal and informal nontariff barriers affecting Canada-U.S. agricultural trade. In the final section of the paper, the general impacts and importance of these barriers are discussed.

## FORMAL NONTARIFF BARRIERS

### Quantitative Restrictions

Quantitative restrictions impose an upper limit on the volume of imports that may enter the country. In order of decreasing interdiction, quantitative impediments to trade can take one of four forms: (1) prohibition, (2) import quotas, (3) licensing procedures, or (4) "voluntary" export restraints.

### Prohibitions

Import prohibitions, which bar trade absolutely, are rarely used in agriculture or food products. Substitutes for butter and processed or renovated butter are the only food products subject to import prohibitions in Canada.[1] The United States maintains no trade prohibitions for food products that could originate in Canada.

### Import Quotas

Import quotas are one of the most effective and widely used barriers to agricultural trade between Canada and the United States. Import quotas limit the volume of products permitted entry into the domestic market within a given time period (usually a year), regardless of price, quality, or other factors. Quotas may be specified as a percentage share of the importing country's market or as a finite number of units. Also, quotas may be country-specific or open to global competition.

Global import quotas may be invoked under Article XI of the GATT, which allows restraints to be implemented, if necessary, to enforce government measures in the operation of domestic supply management schemes. Canada exercises this authority in conjunction with its national supply management program for chicken, turkey, eggs, and dairy products.

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[1] These articles come under the "grandfather clause" of import prohibitions negotiated by Canada when it became a member of the GATT.

Import quotas for these products in terms of domestic production are approximately 6.3 percent for chicken, 0.9 percent for turkey, 0.6 percent for processed eggs, and 0.4 percent for shell eggs. Virtually all of these imports are derived from the United States.

Import quotas for dairy products are maintained for cheese, buttermilk powder, and evaporated or condensed milk. The global import quota for cheese is set at 20.4 million kg., of which 60 percent is reserved for suppliers in the European Economic Community.

Other import quotas operated by Canada affect beef and veal, sugar, and coffee. The import quotas for sugar and coffee are regulated by international agreements and do not directly affect Canadian trade with the United States. The import quota on beef and veal has been in effect since 1982 but has been activated in only one year (1985) and in that case was applied only to manufacturing beef from the United States.

The United States operates import quotas under Section 22 of the Agricultural Adjustment Act of 1933 as amended in 1935 and the Meat Import Act of 1979. Section 22 provides for the use of import quotas whenever it has been established that imports interfere, or are practically certain to interfere, with government price support or stabilization programs. Through its role in protecting domestic agricultural programs, Section 22 limits the scope for negotiating reduced protection. As Johnson notes, "If Section 22 is not repealed, Congress can force violations of any trade agreement" (Johnson).

Although Section 22 import quotas are contrary to the GATT, the United States sought and was granted a waiver in 1955. At the present time, these quotas are in effect for dairy products, peanuts, cotton, and sugar. There are restricting quotas on raw sugar and some products with sugar content. There is also a quota on cotton waste shipments to the United States, but the most important barrier is to the import of dairy products. Dairy product flows are nearly in balance each way but tend to be infinitesimal in terms of either country's production.

## Licensing

Licensing procedures are a regulatory form of quantitative trade restriction. For goods subject to licensing restrictions, agents must obtain an import permit from an appointed regulatory body of the purchasing country prior to entry of the goods. The effectiveness of licensing procedures as a barrier to trade depends on the policy of the regulatory agency. In Canada, licensing procedures are the primary barriers to the import of grains and selected dairy products. The Canadian Wheat Board (CWB) licenses both imports and exports of wheat, oats, barley, and certain prepared cereals. Imports are permitted only when the CWB determines that supplies are inadequate. Typically, wheat imports are nil, and only small quantities of oats or barley enter the country. The CWB also has the power to license imports of semiprocessed products (meals, flours, malts, etc.) but operates a "blanket" licensing policy which does not restrict trade.

The Canadian Dairy Commission (CDC) performs a similar role in controlling the imports of butter and other dairy products. The magnitude of the licensing barrier for dairy products varies considerably. Import permits are freely issued for casein but are seldom issued for skimmed milk powder, dry whole milk, dry whey, caseinate, or animal feeds containing more than 40 percent nonfat milk solids.

### "Voluntary" Export Constraints

"Voluntary" export constraints (VECs) are political agreements obtained from suppliers to limit the quantity of their shipments to the importing country. They are not really voluntary since they are initiated with coercion by the importing country government, and they can be effective in restricting the quantity of imports.[2] The United States used VECs to limit beef imports from Canada in 1982 and 1983. Since 1983, imports into the United States have not reached quota limits, so no further "voluntary" restraints have been necessary.

At the present time, there are no formally recognized VECs operating between Canada and the United States for agricultural products. It would appear, however, that in the case of grains Canada does have a truly voluntary constraint. Opportunities to export selected grades of low-quality wheat to the United States have been lost because the CWB has refused to issue export permits. In most years, there are no wheat exports to the United States, although exceptions do occur, such as the 1985/86 crop year, when the CWB sold 311,000 tonnes of wheat to the United States because of local shortages of high-protein grades. Canada has also restrained exports of millfeed to parts of the United States since August 1985 because of a threatened countervail action (Tosterud).[3]

### Blending Requirements

Blending regulations are a formal type of technical nontariff barrier, but one that is seldom used. They operate by requiring processors to utilize a fixed proportion of domestic inputs in their production formulae. Blending requirements are applied in Canada to limit the use of imported grapes in wine production. The provinces of British Columbia and Ontario require wineries to use a minimum of 80 and 85 percent domestic content, respectively.

### Government Procurement and Distribution Policies

Signatories to the GATT agreed not to practice discrimination in federal government purchases. However, the agreement does not apply to purchases under tied aid to developing countries. In the United States, exclusions apply also to purchases by the Department of Agriculture for farm support or human feeding programs (U.S. Department of Commerce). For these U.S. food aid and domestic food distribution programs, the amounts involved are substantial. Canada excludes Department of Defence and most crown corporation purchases.

State, provincial, and local governments also are excluded from the GATT nondiscrimination requirement. In Canada, provinces favor local suppliers and in some cases will not permit outside bidding unless local supplies are unavailable. Provincially funded institutions are generally encouraged to follow the same policy. States in the United States also have "buy national" or local preference policies. The practice seems to be more important for manufacturing and other services, however, than for agricultural products.

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[2] The degree of effectiveness will likely depend on the political weight that the importing country can bring to bear on the exporters.

[3] This action is an outcome of the Western Grain Transportation Act (1983), which made the U.S. Pacific Northwest an eligible destination for subsidized freight rates.

Provincial governments in Canada practice discrimination in purchase and distribution of alcoholic beverages. Each province has a liquor control board that regulates importation and distribution of these products. Some provinces limit the access of imported wines and beer, while all boards have the monopoly power to control pricing.

Control over pricing permits the boards to favor local wines. For example, in British Columbia the markup on imported wines is more than double the markup for locally produced wines. The differential is even greater in Ontario, and local wines may be sold through company outlets, while imports can be sold only at the Liquor Control Board stores. Board policy also discriminates by applying a rigorous evaluation before imports are listed which is not done for local wines. Foreign producers must meet Liquor Board criteria of quality, price, public demand, marketability, relationship to other similar products listed by the Board, and performance in other markets (Haack, Hughes, and Shapiro, 1981).

Distribution practices discriminate against U.S. beer in several provinces. "The Ontario breweries enjoy retail privileges which make it next to impossible for foreign breweries to penetrate the Ontario market" (Stegmann, 1973, p. 73). The breweries have established a cooperative retail system (The Brewer's Retail), which restricts its membership to firms with brewing facilities in Ontario. The market power of the Canadian brewery distribution system has forced most U.S. brewers to license production for distribution by Canadian brewers rather than attempt to compete through provincial Liquor Control Board stores. Because of the various barriers that exist, about 98 percent of the beer sold in Canada is brewed in the province of sale.

Discrimination of the type practiced in the sale of Canadian wine and beer is contrary to GATT articles. Foreign governments have pressured the government of Canada to rectify the situation. The distribution of alcoholic beverages is, however, under the jurisdiction of the provinces, which leaves the federal government powerless to intervene.

## Safeguard Measures

Both Canada and the United States have legislation providing measures to protect against various subsidies and unfair trading practices. The United States has antidumping and countervail duties as well as an escape clause to provide relief for domestic firms from foreign competition. Canada also has access to countervail and antidumping protection. At the present time, Canada has applied antidumping duties against the import of U.S. potatoes into the province of British Columbia, and a countervail duty on the import of U.S. corn. U.S. potato exporters must adhere to a minimum export price, or the importing agents in Canada will be charged an antidumping levy on these goods. The Canadian countervail investigation against U.S. corn imports, which began in the fall of 1986, resulted in a special duty of US$0.849 per bushel.

The United States has taken countervail or antidumping action, or both, against Canadian exports of pork and live hogs, cut flowers, raspberries, and potatoes. The special duty on live hogs, which has been in effect since April 1985, has been assessed at U.S. 4.39 cents per pound (live weight). This decision is under review and may be dropped or extended to include pork products as well as live hogs. The action against cut flowers consists of a 6.8 percent antidumping duty plus an additional 1.47 percent countervail duty on selected Canadian companies.

Although countervail duties can be classified as formal nontariff barriers, the process of determining countervail may serve as an informal barrier to trade. Under the U.S. system, an individual can use "... a dozen procedures and processes to seek relief from imports" (Steger, 1986, p. 73). Given the legal costs and time involved to defend against a countervail charge in the U.S. trade system, the process alone can serve to punish and deter import competition even if no countervail duty is imposed. There is an additional problem with the definition of a subsidy. "There is a growing danger that any assistance available to foreign competitors that is not provided to U.S. producers (or which is provided by instruments different to those used in the U.S.A.) will be defined as unfair subsidies" (Warley, 1987, p. 3).

### *Temporary Surtaxes*

Temporary surtaxes are permitted under the GATT if necessary to protect producers from injurious imports. Canada has developed a procedure, which is referred to as a "fast-track system," to impose surtaxes on horticultural imports. If import prices drop below a "trigger price" that is assumed to constitute evidence of injury, the surtax may be levied within seven days. However, they have only been used once, in 1982, on onions.

### *User Fees*

In November 1986, the United States introduced a new border charge, or "user fee," for imports. All trucks crossing the border into the United States must pay US$5 per trip, or US$100 per year, while imported goods are assessed a fee of 0.22 percent ad valorem. Although the fee is a relatively minor barrier to trade, it presents a disturbing trend. The appropriateness of an ad valorem charge as a user fee is questionable because it is unlikely that higher-value goods impose greater costs on the customs system than lower-value goods. Moreover, the customs system already collects duties on imports, which should be used to support its activities. Asking importers to pay the cost of collecting a tax they are obliged to pay is merely a thinly disguised nontariff barrier.

## INFORMAL NONTARIFF BARRIERS

### Subsidies and Other Financial Aids

Governments try to improve farm incomes through commodity programs and by sharing the cost of selected production inputs. Cost reducing programs attempt to improve farm incomes through input subsidies and grants which artificially lower the prices of certain production inputs, or ex post, through tax discounts or exemptions. Commodity programs such as deficiency payments, stabilization programs, and export subsidies are among the most prominent government programs that act as informal nontariff barriers. In most cases, government programs for the agricultural sector affect the level of domestic supply. To the extent that changes in domestic supply distort trade flows, government expenditures can be considered informal nontariff barriers.

### *Stabilization Programs*

Canada provides some support and stabilization for a number of commodities, including cattle, hogs, lambs, wool, industrial milk and cream, corn, and soybeans. It also covers oats, barley, and winter and spring wheat where these commodities are produced and marketed outside the Canadian Wheat Board area of jurisdiction (Agriculture Canada). Most of the above stabilization programs require contributions from participating producers. Federal government costs for the programs were estimated to be Can$371 million in 1986-87 (Government of Canada, 1987a). Federal support payments for support of industrial milk and cream alone were Can$287 million.

Canada also provides a measure of stabilization through the Western Grain Stabilization Act to producers of wheat, oats, barley, rye, flaxseed and canola, and mustard, marketed under the Wheat Board. Eligible[4] producers enter the program on a voluntary basis and make contributions to a fund at the rate of 1 to 2 percent of receipts up to a maximum of Can$60,000 in sales. The federal government contributes 4 percent of sales receipts up to the same maximum of sales. Federal contributions to the program have averaged nearly Can$100 million per year, and payments out were relatively small up to 1985-86.

Early estimates show producers received Can$859 million in 1985-86 and Can$1.4 billion in 1986-87 (Government of Canada, 1987b, and Agriculture Canada, Annual Reports, Western Grain Stabilization). Until 1985-86 the program was in surplus based on the producer and government levies; however, a significant deficit was incurred with the large payment in 1986-87, which is guaranteed by the government of Canada.

### *Deficiency Payments*

The primary programs of support in the United States are through direct government deficiency payments and Commodity Credit Corporation (CCC) purchases. While these programs often include provisions for limiting production, they do not require producer contributions to develop the payout fund as is required by most Canadian stabilization programs. The provisions of the U.S. Food Security Act of 1985 specify target and loan programs for wheat, feed grains, cotton, and rice. Dairy has a price support and CCC purchases program.[5] Wool, mohair, and soybeans are protected by price supports, loans, and purchases; peanuts have a two-price support system with production and marketing quotas; and sugar producers are protected through support prices and import quotas. In addition, there are a host of other general commodity provisions that cover trade, conservation, and promotion programs.

The 1985 act sets out a comprehensive framework of government expenditure commitments for 1986-90. In 1985, the U.S. government expenditures for commodity price support and related programs were US$17.7 billion, while under the new act these expenditures exceeded US$25 billion in 1986 because of the levels of deficiency payments.[6] Direct subsidies on 1986 supported grain crops ranged from 60 to 80 percent of market receipts, with wheat target prices, for example, at US$4.38 per bushel and the loan rate at US$2.40. As a result of the impact of the U.S. subsidies on world grain prices, the Canadian government agreed to a special compensating subsidy to be distributed to Canadian grain producers for the 1986-87 crop year.

### *Crop Insurance and Disaster Relief*

The Canadian crop insurance program has joint federal-provincial funding, as well as producer contributions that cover about 60 percent of the cost. Federal contributions in

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[4] Ineligible parties include landlords, noncitizens, and corporations less than 50 percent Canadian owned.

[5] Between 1982 and 1985, net purchases by the CCC exceeded 10 billion pounds milk equivalent per year (Glaser, 1986).

[6] A summary of the act's eighteen titles is presented by Glaser (1986).

1986-87 were Can$221 million, and provincial funding is of a similar magnitude. Livestock and crop drought assistance programs averaged Can$75 million per year for 1984-86.

Crop insurance is provided to U.S. producers by the Federal Crop Insurance Corporation (FCIC), which was created to administer the amended Federal Crop Insurance Act (1980). Producers contribute about 70 percent of the total premium, while the costs of administration and operations and the balance of the premiums are made up by the U.S. government. In 1985, the U.S. government subsidy for the FCIC was US$506 million and is expected to rise to US$557 million in 1986 (Office of Management and Budget, 1986). Although the U.S. government budget proposals envision a privatization and phase-out of the federal role, expenditures are estimated to average over US$400 million per year until 1989 (Office of Management and Budget).

### *Export Subsidies*

The expansion of international demand through export subsidies is widespread. Probably the most widely used form of subsidy is to offer export financing at less than the market rates of interest. Associated programs would include loan guarantees and interest free loans, some forms of food aid, and possibly barter sales.

Canada offers some export subsidies to support sales through the CWB, the CDC, and food aid programs. In 1983-84, the Canadian Government spent Can$21.5 million on agricultural marketing and trade promotion programs and Can$356.4 million on technical and food aid (Rodier, 1985). In the same year, the U.S. government export assistance included agricultural export market development expenditures of US$27.1 million plus export credit authorizations of nearly US$5 billion (Grigsby and Jabara, 1985). Since 1983, the use of "blended credit" and new export enhancement programs have accelerated U.S. export subsidies. An export certificate program provides incentives to export grains amounting to 21 cents per bushel for wheat, 11 cents for corn, and appropriate rates for other grains (Stucker and Collins, 1986). Special sales of U.S. agricultural products involving grants, foreign currency exchanges, donations, and credits have been ranging from US$1 to $2 billion per year.

### *Input Subsidies and Tax Exemptions*

Government programs that subsidize agricultural production inputs represent a significant form of nontariff barrier distorting international trade. These subsidies can be directed to selected inputs (e.g., land drainage and irrigation projects) or apply to a broad spectrum of agriculture through subsidized credit and special tax exemption programs.

Credit subsidies have received increasing attention in recent years because government activities have expanded significantly. In both Canada and the United States, governments have been subsidizing production through credit agencies that insure, guarantee, or make direct loans to farmers at less than market rates of interest. Often these programs are justified by the need to assist young farmers to get established in agriculture. In general, however, subsidized credit has been widely available to both new and established producers.

The total value of credit subsidies is difficult to document. Subsidized credit is provided by different levels of government in both Canada and the United States. One estimate of U.S. federal programs for reduced credit rates and extended maturities for farms in 1983, by the Economic Research Service of the USDA, was US$1.7 billion (U.S. Department of Agriculture, 1984). Canadian Federal Credit program costs generally average less than Can$100 million per year. However, data published in 1986 by the Federal Farm

Credit Corporation indicate accumulated losses of Can$210 million have been written off, while only 81.9 percent of the Can$5 billion loan portfolio was classified as "in good standing" (Farm Credit Corporation, 1986). Indications are that there have also been large loan losses in the U.S. programs in recent years. The costs of provincial farm credit subsidies are not readily available for recent years but in 1982-83 were estimated at Can$312 million (Arcus, 1985). Various credit subsidies are also given by some states in the United States.

Most large water projects in the United States are paid for with federal and state government assistance. While water users do pay some charges, it has been estimated that "Pricing surface water from federal and state projects on a full cost basis would approximately triple the price of water, reduce water use, and thus aid in conservation of water resources" (Knutson, Penn, and Boehm, 1983, p. 348). Irrigation projects in Canada also receive some public funds but are of relatively minor significance.

The tax system is the source of indirect, and in some cases unintentional, subsidies. For example, the cost of raising breeding cattle to maturity has been deductible, while the revenues from the sale of the animal were eligible for treatment as a capital gain. The U.S. Office of Management and Budget estimates these two items amount to a tax expenditure of US$1.4 billion in 1987.

Tax expenditures in Canada vary by province, but in most jurisdictions farmers are eligible for property tax discounts and provincial fuel tax rebates. The value to farmers of provincially granted tax relief in 1982/83 was estimated to be Can$360 million (Arcus, 1985). The federal tax system also offers benefits through use of a cash rather than accrual tax reporting system and federal fuel tax rebates.

### *Transportation Subsidies*

Both the United States and Canada provide transportation subsidies that affect the movement of agricultural products. In the United States most transportation subsidies are for the provision of infrastructure (e.g., inland water routes). In Canada, both direct payments to carriers and indirect assistance for the purchase of transportation equipment or construction of infrastructure are used.

There are few subsidies to direct movements of agricultural products between Canada and the United States, but in selected markets some shipments have been assisted. For example, the government of Canada provides a yearly subsidy of approximately Can$700 million under the Western Grain Transportation Act (WGTA) for rail shipments of prairie grains and oilseeds to export positions (Agriculture Canada, 1987).[7] These subsidies also provide assistance for exports to the United States through Vancouver. As a result, Canadian millfeed exports to the states of Oregon and Washington increased sharply until August 1985, when Canada imposed a voluntary trade restraint in response to U.S. complaints.

Indirect subsidies used by Canada to promote grain exports include about Can$100 million per year to upgrade the standards of railway branchlines on the prairies, and a similar amount for purchase or lease of railway hopper cars and repair of boxcars for grain transport (Canada Grains Council, 1986).

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7. Specifically, subsidies assist transport of grains and associated products to the Ports of Vancouver, Prince Rupert, Churchill, and Thunder Bay.

### *Summary of Subsidies and Financial Aids*

The U.S. commodity price supports and related programs in 1986 exceeded US$25 billion. Total U.S. budget outlays for agriculture (function 350) in 1986 were US$29.9 billion, with about 94 percent for farm income stabilization programs (Office of Management and Budget, 1988). Total Canadian federal government outlays for support of agriculture in 1986-87 were estimated to be Can$3.4 billion, of which approximately Can$2.4 billion was for programs directly affecting farm incomes, including the transportation subsidies. A recent study estimated the producer subsidy equivalent (PSE) to be 22 percent for the period 1982-84 for both the United States and Canada (U.S. Department of Agriculture, 1987).

Total provincial government expenditures on agriculture programs were estimated to be Can$1.6 billion in 1985-86, of which Can$546 million were for programs involving direct payments to producers (unpublished data from Agriculture Canada). Many of the states in the United States also have substantial expenditures for agriculture programs. Data on these programs are not readily available, nor are they included in the PSE estimates.

## Sanitary and Health Regulations

Health regulations are considered necessary, legitimate, and acceptable requirements to protect against imported diseases of plants or animals. On occasion, however, they have been used in an exaggerated manner to provide import protection. The lack of universal standards and a sanitary requirement code creates opportunities for countries to use administrative interpretations of health regulations and border inspections as effective protection devices. These informal nontariff barriers may seem inconsequential, but the costs and associated uncertainty they impose on exporters (and, in particular small or new exporters), can be as effective in halting the flow of products across the border as any of the more formal and visible nontariff barriers.

There are several examples of impediments to trade in livestock and meat and milk products that derive from health concerns. Livestock moving into the United States must be certified as free from selected diseases and incur not insubstantial administrative charges for border clearance, and inspection and brokerage fees.

A blatant example of the use of health regulations as a nontariff barrier occurred following the imposition of countervailing duties on hogs by the United States in 1985. The duties were not considered to be effective in stopping the flow, with the result that South Dakota, Nebraska, and Iowa imposed a ban on hogs given the chloramphenicol drug. This change of regulations served as a virtual embargo against Canadian hogs until Canada banned the use of the chloramphenicol drug (Bruce and Kerr, 1986).

Few hogs enter Canada because of the danger of spreading pseudo-rabies. All imports must be tested for the disease and those testing negative "... may enter the country but are kept in quarantine for 30 days to ensure no presence of the disease. The cost of testing and quarantine is generally sufficient to act as an effective barrier and little movement of live hogs from the U.S. to Canada occurs" (Kerr, Cullen, and Sommerville, 1986). Similar tests for a number of bovine diseases (requiring a twenty-one-day quarantine) act as a significant barrier to feeder cattle imports to Canada.

Meat products from either country require rigid inspections. The United States will not accept meat from plants without a certificate of approval from a U.S. inspector, and U.S. exporters must be certified by Canadian inspectors. Exporters continue to experience uncertainty both in terms of the initial authorization and its continuance. This adds a cost for exporters and acts as a barrier to involvement in trade. And both Canada and the United States restrict the flow of milk products simply by requiring the premises of origin to be certified by local market inspectors but not providing inspectors outside of the respective markets' boundaries.

Commercial standards also serve at times as an informal barrier to trade. For example, differences in the Canadian and the U.S. grading systems for beef and pork tend to reduce trade. Canadian grading favors leaner cuts than the United States with the result that there is less compatibility and flexibility in servicing the respective markets.

Imported plants and fresh fruits and vegetables are inspected for harmful insects and diseases and in some cases are tested for pesticide residues. While most health requirements are accepted as necessary, administrative delays and excessive charges sometimes experienced are considered to be unnecessary restraints to trade. Canadian shippers of highly perishable products also complain that the mere threat of inspection can be an effective nontariff barrier. If a shipment is impounded for testing, unacceptable losses may be incurred, which are not subject to compensation regardless of the test results.

### Labeling, Packaging and Technical Details

Each country has fairly specific and rigid labeling requirements. In Canada, all product labels must be in both French and English. For entry to Quebec, French must precede English. Since label requirements differ, special export labels are required, and approvals must be obtained in the importing country. Particular aspects of the regulations are often the responsibility of more than one agency and sometimes more than one level of government, all of which add to delays and expense for importers (Menzie and Prentice, 1983).

Labeling requirements generally include specifying the country and location of origin. In some instances, packaging standards can be used as a nontariff barrier. For example, Canada has standard size regulations for packages and containers that cover an extensive list of products. Several can sizes for processed fruits and vegetables that are in common use in the United States are prohibited in Canada. Conversion of retail package sizes to metric for Canada and vice versa for the United States presents another form of technical barrier which requires processors, on both sides of the border, to prepare specialized products for their respective export markets. Yet another barrier is raised by Canadian regulations specifying standard containers to be used for shipping products. Bulk shipments are not considered as standard containers and require special permission for entry to Canada; bulk shipments of U.S. horticultural products are subject to approval by Agriculture Canada, which is contingent upon local supply and demand conditions. If permission is not granted, shippers must use more costly forms of packaging to transport products across the border. Canada also prohibits sale of imports on consignment.

### Transport-Related Barriers

In cases where international freight rates differ from domestic rates for equivalent shipments because of regulations, taxes/subsidies, or industry practices, transportation may serve as a nontariff barrier.

Most of the agricultural trade between Canada and the United States is carried by truck. A recent study lists twenty-nine legislative, regulatory, policy, or procedural considerations that might act as obstacles to trucking (Clayton and Sem, 1985). The primary impediments that add to the cost of transportation are operator residency requirements, operating authorities, and weight and dimension regulations, plus delays and administrative costs associated with customs clearance.

Residency requirements prevent Canadian truckers from handling intra-U.S. movements and likewise prevent American truckers from handling intra-Canadian movements. As a result, the availability of backhaul loads can be severely limited, and the cost of "empty" miles must be added to the shippers' bill. Residency requirements probably impose a greater burden on Canadian truckers than on U.S. truckers because most Canadian destinations are relatively close to the border. The distance that American carriers may have to travel empty when returning from dropping a load in Canada is generally less than for a Canadian carrier making deliveries in the United States.

Prior to the U.S. Motor Carrier Act of 1980, regulations known as "operating authorities" restricted the type of cargo and geographical scope of motor carriers. Carriers that held operating authorities earned monopoly profits and contested the applications of new competitors. Consequently, operating authorities were difficult to obtain and could involve expenditures that ranged from the minor costs of application to millions of dollars. Similarly, the time invested in the application process could vary from days to years. U.S. deregulation has eliminated this barrier for American and Canadian carriers operating south of the border, while, in Canada, legislation to remove economic regulation of trucking has not yet been enacted. Most U.S. carriers have already responded by purchasing Canadian firms that have the necessary operating rights (Tausz, 1986), but to the extent that operating authorities continue to restrict competition, the costs of trans-border shipments are increased.

Weight and dimension regulations impose extra costs on transport because they restrict the size and availability of equipment that can be used to haul loads between markets. For example, in California large trucks are restricted to designated routes of the state highway system. Travel off these designated highways requires special permits, which are estimated to add hundreds of thousands of dollars to costs, while the costs of lost productivity arising from restrictions on large trucks run into the millions of dollars (California State World Trade Commission, 1986).

The barrier to trade posed by transportation regulations is reflected in the difference between domestic and transborder freight rates. By comparing the freight charges of equivalent domestic and transborder shipments, the net costs of institutional factors can be approximated. The importance of freight rate differences as a barrier to trade will vary with the value of the product and the distance shipped. Using a 500-mile trip as an example, a study by Prentice and Hildebrand found that the difference between domestic and transborder freight rates was equivalent to a tariff of 0.5 to 0.6 percent for meat products, 1.8 percent for frozen food, 2.1 to 4.1 percent for fresh fruit and vegetables, and 3.5 percent on grains.

## IMPACTS OF TRADE BARRIER REMOVAL

Although, in aggregate, trade between the two countries is confronted with relatively few restrictions, there is considerable variability in policies among commodities. There seems little doubt that reduction or elimination of the remaining barriers would increase trade flows. In a number of instances lower consumer prices should be perceptible. For some sectors of agriculture, however, significant adjustments will be required, particularly in Canada. Improved efficiency should result from greater specialization and larger-scale operations, especially for the more protected sectors. There will be gainers and losers from this process, and the losers cannot be expected to give up preferred positions easily. Since the impacts have been discussed in detail elsewhere, only a brief summary of the highlights will be given here.

Products protected by import quotas and with supply management programs in Canada will experience the greatest adjustment under free trade. These include dairy, eggs, chicken, and turkeys. In each case, considerable capital losses will be experienced with loss of quota values, and internal adjustment in size and location of operations will occur. Following an appropriate adjustment period, however, it is considered the Canadian industry would survive. Furthermore, as domestic prices decline, associated processing industries will be more competitive. While the U.S. poultry industry would not likely experience much impact, the dairy industry could be expected to have some adjustment problems if its special support and other protection mechanisms are eliminated.

The horticulture industry in Canada would experience difficulties facing increased competition. Some aspects would have to phase out, but expansion would likely occur in selected products, and the industry would become more specialized. Grape growers would have particularly difficult adjustments facing loss of a protected market through the domestic wine industry.

Some regional and seasonal changes may occur in trade in livestock, but these would be minor since trade is already relatively free. While institutional and competitive circumstances currently almost preclude grain sales between Canada and the United States, relatively small increases in trade are expected from a free trade agreement. Some adjustments would occur but primarily for regional and seasonal changes in flows. Canadian consumers would gain as would Canadian processors if the two-price system on wheat and barley were eliminated.

Free trade in the wine and brewery industries would force major adjustments in Canada because of current provincial laws protecting local interests. However, following adjustments in location and numbers of plants and reduction in some input costs such as grapes and barley, more specialized but highly competitive industries would develop, with expanded trade in both directions.

## SUMMARY

Agricultural trade between Canada and the United States is of major importance to both countries. While most agricultural trade occurs with minimal tariffs, a number of formal and informal nontariff barriers do significantly affect the flows.

Formal nontariff barriers are defined as government regulations and border controls that have been created to limit imports. Quotas, prohibitions, licensing arrangements, and government procurement policies are the main types of formal nontariff barriers. Informal nontariff barriers stem from government actions, including subsidy and tax policies, which have trade effects that are incidental to their stated purpose. These barriers range from legitimate health measures to subtle forms of restraint such as technical and administrative regulations and have some very obvious trade limiting effects.

This study has found that both countries actively pursue policies that limit or distort trade. The most important sources are from programs intended to improve farm incomes in each country. Various mechanisms for price supports, stabilization, deficiency payments, production input, and export subsidies are employed by both countries. All of these programs directly or indirectly result in trade distortions.

Elimination of the distortions is expected to improve trade flows but is not expected to have much impact on the overall balance of agricultural trade. However, the resulting adjustments from a free trade agreement will have a substantially greater impact on Canadian than U.S. agriculture. Relatively minor increases in flows in selected instances from Canada will hardly be perceptible in the United States. The same level of increases to Canada would also have little impact on U.S. producers but could in some instances, at least, substantially change Canadian production.

Some institutional arrangements in Canada will have to be eliminated or seriously altered if free trade is to be attained. The impacts will be severe in some cases for producers and cause significant changes in some processing and distribution sectors. An open market system would force similar adjustments in the United States, particularly in the dairy industry.

Current U.S. legislation providing relatively large subsidies to grain producers is incompatible with a system of free market-oriented trade. Some major adjustments in this program will be necessary if an agreement between the two countries is to succeed.

Canadian producers tend to fear the potential of their large trading partner to drown them in a sea of production surpluses. Another major concern with current arrangements is the Canadian vulnerability to, and uncertainty regarding, U.S. countervailing duties and restriction of imports under Section 22. Since most Canadian exports, other than grains, go to the United States, Canadian producers see their risks as very high. Except for fruit and vegetable imports, no such potential danger exists for U.S. producers in terms of their exports to Canada.

It will be extremely important in any free trade arrangement to establish procedures that reduce the risks of sporadic action by either country. Regardless of the type of agreement, there will continue to be causes for friction. The potential for such friction must be minimized, as well as the associated risks of remedies, by putting in place an effective institutionalized mechanism for resolving differences.

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# RESOLVING SUBSIDY, COUNTERVAIL, AND IMPORT DISRUPTION ISSUES IN CANADIAN-U.S. AGRICULTURAL TRADE

**William M. Miner**

## INTRODUCTION

An important part of the bilateral trade negotiations between Canada and the United States, and certainly a strong focus of public discussion in Canada, relates to the means of resolving trade disputes between our two countries. Much of the attention is focused on grievances regarding trade in agriculture and natural resources. Although the negotiators face many similar issues in both the U.S.-Canada bilateral negotiations and the multilateral negotiations in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), there are differences, particularly in relation to the use of subsidies that may affect trade and the means of resolving disputes.

We can expect the substantive elements of a new bilateral agreement will include provisions and supporting institutional arrangements that go beyond those envisaged in a new multilateral agreement. This will certainly be the case for dispute settlement procedures if we are to have a new Canadian-U.S. trade agreement that removes customs duties and other restrictions on substantially all bilateral trade.

It may be noted, in this regard, that the GATT has for many years provided a set of rules, however inadequate, largely governing, among other things, Canadian-U.S. trade in agricultural products. The GATT has also provided dispute resolution procedures both countries have used to settle agricultural trade disputes. If hopes are realized, these GATT rules and procedures will be elaborated and strengthened as a result of the Uruguay Round. The bilateral negotiations, on the other hand, could well lead to new rules governing bilateral trade that go beyond those that will emerge through the GATT. They could also lead to the creation of stronger, more structured institutional arrangements than are likely to emerge from the GATT process.

At this point, we can only speculate on the substantive outcomes of the bilateral and multilateral negotiations, and those for agricultural trade are particularly difficult to foresee with any precision. But in both sets of negotiations, there are at least two key areas that are critical to the success of negotiations on agriculture. One area concerns rules to govern the use of subsidies and related instruments in agriculture. The other concerns the development of new yardsticks, or measurements, that governments can use to express commitments and by which their performance under these commitments can be monitored.

## SUBSIDY NEGOTIATIONS: THE KEY TO PROGRESS

Behind many trade disputes lies the question of government subsidies or interventions to promote exports. Even though trade remedy systems are authorized and disciplined by GATT rules, their use has given rise to serious frictions between Canada and the United

States. Many Canadians, for example, believe that the United States uses its trade remedy systems mainly for protectionist purposes, including the harassment of Canadian competitors. Similar complaints are sometimes voiced by Americans over Canadian contingent protection measures. However, because of the importance of the U.S. market to Canadian exporters and the apparent increase in the number of U.S. actions, a key Canadian objective in the bilateral talks is modification of the U.S. system. Nowhere is this more important than in agriculture, and the focus of Canadian concern relates not only to U.S. countervail legislation but also to the use of U.S. subsidies that may damage Canadian exports in third markets.

Since it is unlikely that either government will agree to accord national treatment to each other's products, the solution will have to be found through modifications of the two systems to make them work better and through agreement on the government practices that are acceptable or permissible under each other's legislation. Disputes will be handled through the dispute settlement provisions of the agreement, possibly involving the creation of a joint trade commission. For agriculture, these arrangements may be supplemented by additional agreements and consultative arrangements.

It will be difficult, however, to reach agreement on the types of agricultural subsidy practices that are permissible. A further complication is that subsidy negotiations will be central to the Uruguay Round; thus, the United States will be reluctant to conclude bilateral arrangements on issues that are primarily global in nature and that will be subjected to multilateral solutions. Since progress on this front is essential to achieving an acceptable result for agriculture in both the bilateral and multilateral negotiations, the two countries should, as an initial step, develop complementary approaches in the multilateral trade talks. The Economic Summit countries are committed to tabling comprehensive proposals for negotiating agriculture in the Uruguay Round during the remainder of 1987.[1] The United States has already tabled an ambitious proposal to eliminate, over a ten-year period, all agricultural subsidies and other measures that distort agricultural trade. The Canadian government welcomed this initiative and indicated that it would table a proposal of its own in early autumn.

## MEASURING AND NEGOTIATING REDUCTIONS IN SUBSIDIES AND OTHER TRADE-DISTORTING INSTRUMENTS

The negotiating objective and plan for agriculture agreed to in the GATT identifies "an urgent need to bring more discipline and predictability to world agricultural trade," as well as the need to increase discipline on the use of all subsidies and other instruments affecting agricultural trade, including "the phased reduction of their negative effects" (General Agreement on Tariffs and Trade, 1986). This suggests a general, comprehensive negotiating approach along the lines of the U.S. proposal. Such an approach would provide the maximum scope for involving countries in the negotiations, for sharing the burden of making adjustments to agricultural systems, and for obtaining the greatest benefits for trading countries at the least cost. It would also deal with access and subsidy measures, which are closely linked and difficult to negotiate independently. Further, the success of this approach may depend on finding a way to convert all trade-distorting instruments into one across-the-board measure that would establish some equivalence in measuring the impact of agricultural systems on trade and that would serve as an indicator of progress in reducing these impacts.

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[1] The Summit countries are Canada, France, Italy, Germany, Japan, United Kingdom, and United States.

As others have indicated in their papers in this volume, the most widely discussed measure of the level of income assistance to farmers from agricultural support programs is the concept of producer subsidy equivalents (PSEs). Although they are an indication of income transfer rather than trade distortion, PSEs provide a useful measure of the impact of support programs on agricultural commodities in various countries. However, a number of important factors that influence the calculation are largely outside the control of any one country. These factors include changes in world prices and exchange rates, and the cross-effects of some programs on different commodities. In addition, the difficulty of calculating the impact on income of measures such as supply controls and acreage reduction programs also limits the usefulness of PSEs. Thus, PSE comparisons between countries are difficult to make with precision and the calculations are complex and subjective.

It has been suggested that a better measure might be a "price adjustment gap," or a PSE measurement adjusted to relate it more closely to the trade-distorting effects of policy instruments. Another suggestion has been to use a simple technique for negotiating commitments based on the unit value of a subsidy or program provided for a commodity and the quantity that benefits from the subsidy. For some programs, such a calculation would be difficult, but the concept is more readily explained and understood.

Clearly, additional work is needed to develop a fair and simple measure that can be expressed in an understandable manner to governments and to the farmers who will be affected by changes. It would appear to make good sense to form an independent group within the GATT framework, possibly composed of experts drawn from the GATT and the Organization for Economic Cooperation and Development (OECD), to prepare and maintain estimates of the trade effects of key national programs.

Ideally, governments would accept a general commitment to reduce all subsidies, import restrictions, and related instruments that directly or indirectly affect agricultural trade by an agreed amount over a period of time. The U.S. proposal to phase out all import restrictions and subsidies over a ten-year period is ambitious, but it establishes an objective that merits wide support. Each country would retain flexibility in the choice of programs to be reduced over the period, although a package of adjustments for various commodities and countries would have to be developed to provide a balance of benefits and concessions. The trade effects of policy instruments could be measured in terms of quantities affected, and prices could be expressed in national currencies. An ongoing monitoring and consultation procedure also would be required.

It would be easier to negotiate such a general commitment if a classification procedure were developed for the various types of agricultural programs to be used as a guide. This would allow the negotiating teams to address the programs in a broad, comprehensive manner, rather than in the context of specific commodities and instruments. This procedure would be based on the purpose of the programs and their trade-distorting effects. Criteria for developing the categories could include whether the subsidy or other policy instrument is generally available or targeted at specific commodities or industry sectors. A summary measurement, possibly a trade-derived PSE, of the trade-distorting effects of specific programs would serve as an indicator to assist in classifying programs. Instruments affecting the production, consumption, and trade of agricultural commodities might be classified largely according to the OECD overview of agricultural policy instruments, as follows:

- Framework measures--generally not trade distorting
- National agricultural services--generally not trade distorting
- Stabilization programs--may be trade distorting
- Indirect income support--usually trade distorting
- Direct trade measures--usually trade distorting.

It will prove difficult, however, to describe such general commitments in precise, legal language that can be subjected to monitoring and dispute settlement procedures. In addition, some government measures create more severe distortions for trade than others and there will be a desire to ensure that such measures are disciplined. There is also some risk that governments may shift subsidies from trade-distorting to non-trade-distorting categories to such an extent that the latter come to affect trade adversely. To avoid this, measures that are usually trade distorting should be subject to specific disciplines in addition to the general commitment to reduce their trade effects. Strengthened GATT rules should be negotiated that would apply to those measures that are usually trade distorting. These rules, based on existing GATT articles, would aim at the eventual removal of all such trade-distorting measures and would establish conditions for permitting their use prior to phasing them out.

Provided that Canada and the United States are able to negotiate subsidies along similar lines in the Uruguay Round, and to table proposals in the GATT talks accordingly, they could proceed to incorporate some of the provisions as an integral part of the bilateral agreement. This may provide a basis for a satisfactory approach for dealing with agricultural subsidies as part of the overall subsidy negotiations between the two countries. It would strengthen each country's position on subsidy negotiations in the multilateral negotiations. Furthermore, it would demonstrate that two major agricultural trading countries are able to find solutions to issues that are central to the world agricultural trade problem.

## DISPUTE SETTLEMENT MECHANISMS

In addition to the general provisions governing dispute settlements, appropriate institutional arrangements and procedures will be needed to back up and supervise the operation of new bilateral and multilateral agreements on agricultural trade. These arrangements will differ in structure and form, but should be designed to serve the following functions, among others:

- To supervise the operation of the agreements and to advise governments on improvements to their agreements
- To monitor performance under the commitments that are entered into
- To receive and analyze information and data on government policies and practices, and to provide measurements of their effect on international trade
- To help governments resolve disputes through a process of conciliation, or perhaps arbitration.

The bilateral agreement might well create a form of independent joint trade commission, which could play an advisory role and also be given decision-making authority in specified areas.

On the assumption that both countries will agree to reflect, as much as possible, their overall multilateral proposals in the bilateral accord, they may, for example, agree to prohibit the use of direct trade measures on trade with each other. They may agree that certain subsidies that are not trade distorting are permissible with respect to each other's contingent protection system. They may agree to other modifications in their trade remedy laws, or in the administration of these laws; suggestions include the concept of "net subsidies" in determining whether products are subsidized, a redefinition of injury, and an increase in the *de minimus* levels that determine whether a product is being dumped or subsidized. As Frank Stone and Tom Burns stated in a recent paper:

> Alternatives to existing trade remedy practices will need to be found. An agreement that fails to change the present systems would be unlikely to find much support in Canada. Uncertainties about access to markets would persist that would seriously undermine the basic purpose of the agreement; and the kind of bilateral frictions over important trade issues that have existed over the past several years would continue, undermining other areas of Canada-U.S. relations (Stone and Burns, 1987, p. 93).

It may be assumed that the two negotiating teams are now well engaged in negotiating stricter disciplines on subsidies affecting cross-border agricultural trade and in discussing new institutional arrangements to monitor this trade and resolve disputes. Both within the OECD and at the Venice Summit, the two countries have declared their willingness to negotiate reforms in national agricultural policies that affect trade. They should be prepared to avoid serious prejudice to each other's trade as part of a bilateral agreement, and they should be ready to back this up with procedures for consultation and remedial measures. Such measures could be implemented based on existing GATT provisions and possibly be revised following the Uruguay Round. A joint consultative committee on agricultural trade, created as an extension of the general dispute settlement procedures of the bilateral agreement, would seem to be appropriate to facilitate the resolution of trade disputes in agricultural products between the two countries. Consultations could be conducted on the basis of well known procedures in the GATT and the Committee on Surplus Disposal of the United Nations Food and Agriculture Organization.

A broad approach in the GATT to reduce or eliminate all measures that distort agricultural trade will require unique dispute settlement arrangements. Some form of policy surveillance body would be required to monitor performance, possibly to negotiate adjustments, and to help resolve disputes.

These arrangements could take the form of a policy committee on agriculture composed of signatory countries. An annual review of performance under the general commitments could be undertaken. If the committee were unable to agree, disputes could be referred to a panel of independent experts. Strengthened monitoring and technical support by the GATT Secretariat would be required, including the capability to measure the trade effects of various instruments. More specific commitments would be handled under the regular GATT dispute settlement procedures. The fact that the bilateral and multilateral negotiations are proceeding in parallel offers a unique opportunity to make progress on these issues, which are vital to the future of agriculture in North America.

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# DISPUTE SETTLEMENT IN AGRICULTURAL TRADE MATTERS: THE LESSONS OF THE GATT EXPERIENCE

## Robert E. Hudec

The subject of dispute settlement appears near the top of the negotiating agenda in two major trade negotiations currently in progress: the Uruguay Round of multilateral GATT (General Agreement on Tariffs and Trade) negotiations and the bilateral negotiations between the United States and Canada. The purpose of this paper is to examine how the dispute settlement aspects of these negotiations are likely to affect the regime for agricultural trade.

### DISPUTE SETTLEMENT

The first step is to define dispute settlement, for the term means something a bit different than it seems. In the GATT, the term refers to a litigation procedure--a process under which one government can "sue" another for violation of its legal rights. It means a procedure in which there is a neutral tribunal of expert judges that will rule on the legal complaint, issue orders to comply if there is a violation, and sometimes, in cases of serious violation, authorize the aggrieved party to take retaliatory trade action as compensation or as a sanction.[1]

Dispute settlement is not a term that most people would use to describe a lawsuit. In diplomatic parlance, dispute settlement normally refers to nonadversarial processes--such as negotiation, conciliation, mediation, "good offices," and the like--for settling conflicts. Diplomats have chosen to attach this misleading label to GATT litigation procedures because (1) they view lawsuits as a form of conflict and (2) they have been trained since birth *never* to admit publicly that relations between governments have deteriorated to the point of conflict. After many years of such mislabeling, GATT diplomats are now slowly coming around to the view that litigation is not such an uncivilized form of behavior after all. By the end of the Uruguay Round, it is possible that the true legal character of GATT dispute settlement may even be openly recognized.

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[1] The GATT agreement also provides for legal rulings on claims that the action of another government, while not in violation of any legal obligation, has nonetheless "nullified or impaired" the attainment of benefits reasonably expected under the GATT agreement, and that compensation is therefore owed to the injured party in order to restore the balance of benefits. This type of legal claim, known commonly as nonviolation nullification and impairment, is provided for in GATT Article XXIII:1(b).

## THE CURRENT REFORM PROPOSALS

In order to understand the current wave of interest in dispute settlement procedures, one must first understand the nature of the reforms being advocated. In the GATT negotiations, most of the reform advocates have stated that the general purpose is to "strengthen" existing procedures, which usually means making the litigation process run more smoothly, more rapidly, and with fewer obstacles to the issuance of clear and binding legal rulings. This objective has been on the GATT agenda since the beginning of the Tokyo Round, and there has already been fairly substantial progress in this direction.[2]

Current proposals include:

- Rules that would reaffirm every party's right to have claims heard by a "panel" (the GATT name for the tribunal that hears such cases)
- Time limits and other devices to make the procedure move forward more rapidly
- Rules to improve the process of selecting panel members
- Changes in the "consensus" decision-making practices of the GATT Council in order to limit the losing party's ability to block the Council's issuance of binding legal rulings

The focus of current reform efforts seems limited to the making of the GATT legal ruling itself--swiftly, surely, and with maximum authority. The proposals have not yet gone so far as to recommend making GATT legal rulings effective in domestic law, as are rulings of the European Court of Justice. Nor do current proposals seem to be looking for other ways of making GATT law effective in national law--by, for example, enacting certain GATT rules as mandatory national law enforceable by national courts.

Turning to the dispute settlement issue in the Canadian-U.S. negotiations, public statements and news accounts indicate that the issue figures prominently in Canada's

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2. In the Tokyo Round, there were two sets of reforms. For legal disputes under the existing provisions of the General Agreement, the applicable procedures (those established by GATT Article XXIII) were "restated" in a lengthy document purporting to describe existing practice (see "Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance," in GATT, 1980, pp. 210-218). Then, each of the separate new "Codes" negotiated in the Tokyo Round had its own dispute settlement procedures. These procedures were generally made "stronger" than the basic Article XXIII procedures, with such added features as an automatic right to have a claim heard by a panel and time limits on the various stages of decision (see, for example, "Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade" (Subsidies Code, Article 17), in GATT, 1980, pp. 56-83).

   Two further decisions were taken in the years following the Tokyo Round. In 1982, a Ministerial Resolution called for several measures to make the procedures operate more rapidly, with clearer decisions and more effective follow-up (GATT, 1983a, pp. 13-16). In 1984, a decision of the Contracting Parties provided for creation of a roster of nongovernmental panelists and authorized the Director General to appoint panelists from that list if necessary to break deadlocks over selection (GATT, 1985, pp. 9-10).

negotiating objectives. Canadian statements have given particular emphasis to the need for a "binding" dispute settlement process, but to my knowledge it has not yet been made clear whether this demand refers merely to the international legal character of such rulings or whether it is also meant to require some kind of binding legal effect in the domestic law of the losing party. Indications are that U.S. negotiators have been unwilling so far to agree to the "binding" element of these demands, whatever it means.

## THE ANTICIPATED GAINS FROM STRONGER DISPUTE SETTLEMENT PROCEDURES

What are governments hoping to accomplish by writing, or rewriting, procedures for the conduct of lawsuits?

The general answer, of course, is that governments expect dispute settlement procedures to help to achieve trade liberalization. Lawsuits, or the threat of lawsuits, are expected to persuade governments to remove, or not to impose, trade barriers.

With respect to the current GATT negotiations, it may be useful to distinguish three situations in which stronger dispute settlement procedures might be expected to have some impact on another government's trade policies.

The first is where there is *already* a GATT rule prohibiting a certain trade barrier, but where the rule is not currently being observed. When governments complain that other governments are not playing by the rules, they often turn to stronger dispute settlement procedures as a way of trying to rectify the perceived imbalance. The issue in such cases is always whether dispute settlement reform will actually affect the causes of previous noncompliance.

The second situation is where new rules are being written in the negotiations and where governments want assurances that others will comply as well as they do. Unlike tariff negotiations, where the other party's *quid pro quo* is an immediate change in tariff rates that can be seen and measured, the negotiation of new rules on nontariff barriers involves no tangible act of compliance, for such rules are mainly promises *not to do* some things. Governments look to strong dispute settlement procedures to supply the tangible assurance that promises really will be carried out.

The third setting, and the most problematical, is the one in which governments seek to enforce rules that are defective or incomplete. Governments sometimes look to dispute settlement proceedings as a way of creating additional law that will fill these gaps. This third function is sometimes looked to as a second-best solution to a negotiating impasse--a solution where governments, in place of an express prohibition to which they cannot agree, will agree to a few more general objectives of less binding character, coupled with a dispute settlement procedure that will be used to refine and enforce these objectives in the future.

In the Canadian-U.S. negotiations, the emphasis on dispute settlement most likely represents the second of these situations--an attempt to create the maximum assurance that the other side (that is, the United States) actually will live up to its promises. It is possible, however, that as certain negotiating impasses develop (for example, over demands for limiting antidumping and countervailing duty laws), parties may look to dispute settlement procedures to serve the third function--a means of trying to achieve indirectly some of the things that cannot be achieved directly.

How do these objectives of dispute settlement reform relate to the problems of agricultural trade in particular? In the GATT, there is a very substantial connection. The GATT has experienced a rather high rate of failure in enforcing its rules on agricultural trade, and a good bit of the blame for these failures has been attributed to inadequate dispute settlement procedures. Consequently, much of the current demand for reform of GATT's dispute settlement procedures comes from the agricultural sector. It is an important part of a more general demand for improved GATT discipline over agriculture.

The agricultural trade aspects of the Canadian-U.S. trade negotiations are not yet clear enough to permit an assessment of whether they are connected to the dispute settlement issue in any special way. There seems to have been little connection between the two in what has happened so far. In the final analysis, however, the lessons of GATT's experience with agriculture undoubtedly will be applied, at least in a general way, to whether agricultural rules appear in the free trade area agreement.

We now turn to the central question: what kind of impact, if any, is dispute settlement reform likely to have on agricultural trade problems both in the GATT and in a Canadian-U.S. free trade area?

## THE GATT EXPERIENCE

The modern era of the GATT's rather substantial experience with dispute settlement dates from about 1960. Around that time, give or take a year or two, European countries ended the era of the Marshall Plan and inconvertible currencies, the European Community (EC) began to function in place of its original six member states, developing countries became a majority of the GATT membership and organized as a bloc, and Japan began to be treated as a potential superpower.

### The Volume of Agriculture Litigation

First, some numbers. For the purposes of my own research, I count as a GATT "lawsuit" any legal claim that is announced to the GATT as a whole, and that either requests a legal ruling or takes the first step in the formal Article XXIII procedure that leads to such rulings. Because this overall definition of lawsuits includes a lot of claims that are settled or dropped without going any further, I also count a second, narrower category of cases--those that actually result in the creation of a tribunal ("panel") or some other adjudicatory body.

Since 1960, GATT governments have filed 107 lawsuits, fifty-nine of which have proceeded to the second stage of adjudication. The frequency of lawsuits has increased each year--from a relatively slow pace in the early years to a quite active business today. Of the total of 107 lawsuits filed, eighty were filed in the past ten years--eight per year--while forty-three of the fifty-nine litigated cases have occurred during the past ten years--about four per year. It is fair to say that dispute settlement has become a major item on the GATT agenda during the past decade.

How do cases involving agriculture figure in this caseload? The answer is that they have been disproportionately important. Of the total number of lawsuits filed, 46 percent (forty-nine of 107) concerned trade restrictions primarily affecting agriculture or fishery products. Almost the same percentage of the litigated cases were in this category--twenty-six of fifty-nine, or 44 percent.

Which GATT members were the primary source of complaints over agricultural problems? The answer is rather dramatic. Of the forty-nine lawsuits concerning agriculture and fishery products, twenty-seven involved claims against agricultural trade practices of the European Community (EC). The rest of the complaints involving agriculture were scattered among various defendants--five against the United States, six against Canada, three against Japan, and the rest among Denmark, Spain, Switzerland, Brazil, Chile, and India.

What was the reason for the disproportionate volume of agriculture cases? The answer would appear to lie mainly in the volume of complaints against the EC. The reason for the EC complaints, in turn, seems clearly to have been the very substantial changes wrought by its Common Agricultural Policy (CAP). Nothing excites claims of trade damage like changes in existing trade patterns, and no government policy has caused more change since 1960, in any area of the world economy, than the CAP.

Two other factors may have contributed to the general frequency of agriculture litigation in the GATT. First, it is probably true that the more a government is involved in a market, the more likely it is that producers from other countries will complain when changes in that market injure their interests. Second, and more important, if it is true that farm interests, for whatever reason, wield a disproportionate amount of political clout when it comes to protecting themselves in terms of domestic policy, it can probably be expected that they will also wield disproportionate power when it comes to their claims against foreign governments--in other words, governments will be more likely to sue when farm interests are injured than when other interests are injured.

One can anticipate that these last two factors would exist under a Canadian-U.S. agreement as well, so that agricultural trade disputes will probably continue to demand more than their share of legal attention. However, there do not appear to be any policy changes on the horizon as dramatic as the CAP. Thus it is unlikely that, in the Canadian-U.S. context, agriculture will take up the disproportionate amount of time it has taken in GATT legal affairs.

## The Rate of Legal Failure in Agricultural Cases

Since 1960, there have been about ten cases in which GATT dispute settlement proceedings have produced results that GATT members generally have recognized as a "failure." Of these, only two were nonagricultural cases: a group of four related cases involving tax legislation--the so-called DISC (Domestic International Sales Corporation) cases[3] --and a complaint by Canada against the United States involving Section 337 procedures under U.S. law.[4] The other eight "failures" all involved agricultural claims--six against the EC, one against Spain, and one against the United States (which the United States linked to the EC cases).

Of the six "failures" involving complaints against the EC, four involved export subsidies--two complaints by Australia and Brazil about sugar and two U.S. complaints about wheat flour and pasta.[5] The EC actually "won" three of four export subsidy cases, in that the GATT panel was unable to find any violation; it was the plaintiffs, and their supporters, who considered the results unacceptable. In the fourth export subsidy case, on pasta subsidies, the panel ruled the subsidy to be illegal, but the EC refused to accept the decision. The other two lawsuits against the EC in this group also involved U.S. complaints, one about domestic production subsidies on canned fruits and raisins, and one about tariff preferences on citrus products. Both panel reports supported the U.S. complaint; the EC rejected both.[6]

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[3] The panel reports in the four cases are printed in GATT (1977), pp. 98, 114, 127, and 137. The panel ruling in three of the cases was eventually overruled, in part, by the GATT Council decision several years later that accepted the panel reports (GATT, 1982, p. 114).

[4] The panel decision, finding the U.S. law not in violation of GATT obligations, is reported in GATT (1984), p. 107. After a year of debate about the dissatisfaction with the panel's legal conclusions, the GATT Council agreed to accept the report on the understanding that this would not preclude further examination of Section 337's consistency with GATT obligations. For a summary of the follow-up proceedings, see GATT (1983b), pp. 44-46.

[5] The panel reports on the Australian and Brazilian complaints involving sugar subsidies are reported, respectively, in GATT (1980), p. 290; and GATT (1981a), p. 69. The panel reports on the two U.S. complaints involving wheat flour and pasta subsidies have not yet been published, because the GATT documents containing the reports have not been derestricted.

The "failure" involving Spain was a U.S. complaint against certain Spanish restrictions on soybean oil. The panel report supported the legality of Spain's actions, but the United States and a number of other contracting parties found this ruling unacceptable.[7] The last of the eight cases was more a casualty caused by other failures than a failure in its own right. It involved an EC complaint about U.S. countervailing duty law on wine. Although the panel report supporting the EC claim was never challenged on its merits, the United States refused to accept it until the EC accepted the panel reports in the cases the EC had lost.[8]

Although there have been many failures on agricultural problems, the surprising thing is that there were not many more. The legitimacy of the GATT's rules pertaining to agriculture was dealt a crippling blow by a 1955 waiver that, for all intents and purposes, exempted the United States from those rules.[9] This precedent made it all but impossible to insist that other governments respect GATT rules on agriculture when removing their balance of payments restrictions in the late 1950s and made it impossible to object when the EC proposed an autarkic CAP based on the variable levy in the early 1960s. While this breakdown of observance has not completely prevented the adjudication of occasional lawsuits under the GATT's rules, it has given such litigation an almost surrealistic quality.[10] More important, it has given legitimacy to the behavior of governments when, in cases involving agriculture, they block the process and refuse to accept a decision.

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[6] The reports in both the canned fruit and the citrus cases are still restricted and have not yet been published.

[7] The panel decision itself has not been derestricted. For a summary of the GATT Council discussion and its decision to "note" the case (a polite way of saying it had decided not to "adopt" the decision), see GATT (1981b), pp. 26-32.

[8] The panel report has not been published, because it has not yet been derestricted.

[9] The waiver, which excuses all U.S. measures taken under Section 22 of the Agricultural Adjustment Act of 1933, is printed in GATT (1955), p. 32.

[10] For example, one finds two GATT lawsuits in the mid-1970s in which the United States complained that certain EC agricultural trade measures were in violation of the GATT, despite its own waiver from those same obligations (see "EEC--Measures on Animal Feed Proteins," GATT, 1979, p. 49; "EEC--Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables," GATT, 1979, p. 68). In both cases the panel found certain EC measures in violation, and the EC, having already withdrawn the measures or allowed them to expire, agreed to accept these legal rulings.

Whether the process could have produced an effective legal ruling in a case involving a live body was not clear. The United States had defended its arguably two-faced legal posture by claiming that, if the EC wanted the same legal freedoms as the United States, it too should seek a waiver. From a legal point of view, this position was correct enough; politically, it was not a platform from which one could launch any really large stones against the other fellow's glass house.

The absence of consensus sometimes manifests itself in the form of rules that have no objective content. In the area of export subsidies on primary products, for example, the GATT has never really had enough consensus to be able to define a rule that can be applied. The rule of Article XVI:3, which also appears in Article 10 of the 1979 Subsidies Code, prohibits governments from using export subsidies to gain more than an "equitable share" of world markets. The "equitable share" rule was actually applied in 1958 against France (see "French Assistance to Exports of Wheat and Wheat Flour," GATT, 1959, p. 46) but when attempts were made to apply it against strong opposition from the EC in 1978 and 1981, panels were unable to find any objective criteria that could supply a solid enough justification for a decision finding the EC in violation.[11]

As two other cases show, however, even a clear rule is not enough if there is no underlying consensus in support of it. One of the cases involved an EC subsidy on exports of pasta; the other involved an EC domestic production subsidy on canned fruits and raisins.[12] In both cases, the EC subsidy allegedly had two components. One component, which can be called "compensatory," was a sum to compensate processors for the artificially high cost of raw materials caused by a price support program, in order to permit them to compete on an equal footing with processors in other countries who had access to raw materials at world market prices. The second component, which can be called "competitive," was a further amount designed to create a competitive advantage over other suppliers.

The applicable rules in each case seemed to say that the entire subsidy was inappropriate--that *both* components were wrong and deserved a legal remedy.[13] The United States pressed for a decision so ruling. While there was consensus that the competitive component of the subsidy was wrong, many governments joined the EC in arguing that the compensatory component was fully justified and that any rule requiring its elimination was simply wrong and inadmissible. They argued that the GATT had accepted price supports programs, which necessarily implied acceptance of the subsidies needed to protect one's own processors against the higher prices such programs invariably created. It had never been agreed, they argued, that a country had to sacrifice its processing industries in order to have a price support system. This opposition proved decisive. Although the United States had the rules on its side and won a favorable decision from the panel in both cases, the EC managed to block acceptance of both decisions.

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[11] In addition to the open content of the equitable share rule, it also presents difficulties by stating the standard in terms of market effects. Rules that cannot be applied until one sees the effects of a measure provide little restraint at the point of decision, and always leave the future open to argument.

[12] As noted previously, since neither of these decisions has been approved, governments have not been able to agree on their derestriction. Thus, they remain unpublished.

[13] The rule in the pasta case was Subsidies Code Article 9, which flatly prohibits export subsidies, with no exceptions, on all products that do not qualify as "primary products." The canned fruit case involved a claim of nonviolation nullification and impairment under Article XXIII:1(b), where prior precedents seemed to say quite clearly that a production subsidy on a product subject to a tariff binding would constitute nullification and impairment of the benefits reasonably to be expected from the binding.

### The Subsidies Code

The United States and some other governments hailed the negotiation of a new GATT Subsidies Code in 1979, as a part of the Tokyo Round agreements, as an answer to this lack of consensus. Unfortunately, the key lawsuits brought to enforce the new Subsidies Code--the cases involving EC export subsidies on wheat flour and pasta--ended in the same kind of impasse as before. Closer examination would have predicted these results, for it would have shown that the Subsidies Code had never really achieved any new consensus on the key agricultural trade policy issues in dispute.

At the outset of the Tokyo Round, the EC had made clear that it was unwilling to make any basic changes in its CAP, asserting more than once that the basic elements of the CAP were simply nonnegotiable. The EC also announced at the beginning of the Subsidies Code negotiations that it did not have authority to agree to any new rules on subsidies. It did bend this position slightly, however, by agreeing to a new Subsidies Code that would repeat existing subsidy rules, in a slightly more precise manner, and that would also create a new and better dispute settlement procedure to apply those rules. The United States understood the very limited nature of the consensus underlying the Subsidies Code, but it initiated GATT litigation anyway--partly in the hope that the stronger litigation procedures might somehow be able to create legal prohibitions that it had not been possible to create in express terms over the negotiating table. As indicated above, the litigation failed.

The Subsidies Code experience led to an interesting, but very wrong, "lesson" about GATT dispute settlement. The United States blamed these litigation failures not on the inadequacy of the Subsidies Code as such but on the inadequacy of the GATT dispute settlement procedures. The failures were explained by pointing out that the procedures operate by consensus, thus allowing defendants to block adverse rulings, and that various other aspects of the procedure allow for delay and obstruction that also makes it difficult to obtain clear rulings. This was a politically convenient explanation, of course, for it tended to excuse from responsibility both the U.S. administration, which negotiated the Subsidies Code, and Congress, which paid value for it. And, indeed, it apparently remains a convenient explanation. The great prominence being given to dispute settlement reform in the Uruguay Round is due, at least in part, to the continued repetition of that excuse--a repetition that, by now, seems to have persuaded the speakers as well as the listeners.

## THE LESSONS

In my view, the primary reason for the many failures of GATT dispute settlement in agricultural trade problems has been, and remains, the weakness of substantive rules in this area.

The lessons for the Uruguay Round are quite simple. As the experience of the Subsidies Code demonstrated quite vividly, better dispute settlement procedures are not a substitute for a new set of consensus-based rules in agriculture. Dispute settlement reform may well be worth doing for its own sake. But it will make no contribution to the legal breakdown in agricultural trade unless it is preceded by a new and meaningful agreement on substantive rules.

One particular warning seems appropriate with regard to the proposals to negotiate new substantive rules in terms of producer subsidy equivalents (PSEs). The PSE concept is potentially very vague, and the rush to "early harvest" (or even "late harvest") may well create temptations to define PSEs in a general way, leaving many of the hard, substantive issues to be settled by dispute settlement procedures. It is always necessary to leave some question of application to adjudication, of course, so one cannot insist on perfect definitions. But if the past teaches anything in this area, it is that dispute settlement cannot solve the kind of substantive conflicts that must be resolved before any definition can be said to represent a consensus. These conflicts will have to be addressed across the negotiating table.

The primary lessons of this experience for a Canadian-U.S. agreement are the same and do not require further elaboration. The main ingredient for enforceable rules in this area will be solid agreement on the substance, clearly expressed. Negotiators should not be looking to win in dispute settlement what they cannot win at the negotiating table.

Conversely, if genuine agreement is won at the negotiating table, it will not need solid silver dispute settlement procedures to make it effective. Any procedures that lead to prompt and objective legal rulings should be able to harness the main force of such obligations. It is not worth spending much negotiating capital on the finer points of binding legal quality.

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# RESOLVING AGRICULTURAL TRADE DISPUTES

## Thomas Reese Saylor

During my tenure as an official of the U.S. government in the late 1970s, the preoccupation of agricultural policymakers was whether American agriculture could expand to meet the insatiable demand for imports throughout the world. Market development was easy. If you could grow it you could sell it. Today, agricultural and trade policy officials face an entirely different set of issues and problems.

While I may not agree with some of the approaches of the current administration in agricultural trade policy, I respect the difficulties it has had to face. The current situation of oversupply, a situation that has characterized developed-country agriculture for much of the past sixty years, creates a climate of growing tension within which cooperation is elusive.

We now face a situation of burdensome worldwide oversupply of most major agricultural commodities. Rather than undertake multilateral solutions, agricultural producers have typically found it politically expedient to dump their excess production onto world markets. Belatedly countries, the United States included, have been forced into stockpiling and/or production controls. Yet few are willing to address the national price or income support systems that provide the primary incentive to produce commodities for a market unable to absorb additional supplies.

The major agricultural exporting nations have an opportunity and obligation to undertake major reform of national policies that exacerbate trade frictions in agriculture and unduly burden their own taxpayers. The opportunity arises out of a growing public recognition of the imbalances represented by these nations' agricultural policies and the burdensome costs of farm support. However, some of the current policies being pursued by the United States and other nations run contrary to creating the climate within which that objective can be achieved.

Unfortunately, U.S. policy officials have fallen prey to the politically popular strategy of trying to beat others at their own game. In response to the European Community's (EC) export subsidies, the United States has constructed its own program of export subsidies. As of July 1, 1987, the U.S. Department of Agriculture had announced export subsidies to support the sale of almost 30 million tons of grains and products. Large quantities of table eggs, frozen poultry, dairy cattle, and vegetable oil had been sold abroad with subsidies. The market value of awards is about US$1 billion. Authority is being sought to add another US$1.5 billion to the export subsidy "war chest."

What have we bought? Some would argue that we have bought increased exports. We are, in fact, seeing some recent improvement in export sales. However, I believe that the impact of export subsidies has been very small and the relationship to the short-term improvement in exports is an illusion. The nature of world markets and national systems is such that essentially all of America's competitors export against an exportable supply. That is, they export what is available to export because the level of exports is a decision of governmental or quasi-governmental bodies and not solely of the market. If they produce a given quantity, the amount in excess of domestic requirements will be priced to move into export channels. The United States is the residual supplier--building up stocks and retiring land and adjusting sales in response to imbalances in world supply and demand. U.S. subsidies may restructure the patterns of trade but have little impact on the total volume of exports. What U.S. subsidies have done is lead world prices down so that we get less for what we actually sell.

If driving world prices down forces our competitors out of business or encourages consumers to buy enough at lower prices to offset the lower unit income, it could be argued that our subsidy program would eventually benefit U.S. producers. However, there is little to indicate that this is, in fact, the case.

In many instances, producers and consumers are insulated from world prices by domestic programs. Competing production area has fallen only modestly over the past several years, more to weather conditions and shifts between crops than to a conscious, long-term program of rationalizing production with demand. Despite a 27 percent increase in corn export volume, the total value of corn exports dropped 7 percent in fiscal 1987. Similarly, wheat exports fell 11 percent in value in spite of an 11 percent increase in volume (U.S. Department of Agriculture, 1987).

The U.S. program of export subsidies, the Export Enhancement Program (EEP), is often justified as a means by which we can reduce or eliminate unfair trade practices of the European Community. The farm support programs of our competitors have certainly become more costly as we have forced world prices down and increased the amount that they have to pay in subsidies. In Europe, the weak dollar has put further pressures on EC agricultural support program costs. Yet, there is little evidence that these subsidies have brought the Common Agricultural Policy (CAP) "to its knees." In fact, since the United States exports about three times the volume of grain, for example, as the European Community, subsidizing grain exports means it effectively costs the United States three times as much, either directly in subsidy costs or indirectly in reduced export income.

Why then are we using export subsidies? Having spent many years working both in Congress and the administration, I am inclined to take the somewhat cynical view: "if you can't do something meaningful about the farm trade problem, you should at least do something that looks as though you are doing something about the problem." In other words, it looks good politically to get tough with the Europeans. Yet, an atmosphere of hostile language and retaliatory actions is unlikely to create the political climate for cooperative efforts aimed at rationalizing national agricultural support systems. Foreign politicians and policy officials are no more inclined than our own to respond positively to such approaches.

Perhaps of even greater concern is the shift in trade policy philosophy by the United States implied by the EEP. Despite our long experience with the use of export subsidies, the United States has attempted to exhibit what might be called "moral leadership" in the evolving international framework of trade policy. The expansion of demand in the 1970s gave the United States an opportunity to remove some of the worst features of agricultural programs that distort our own agriculture and trade. By dismantling those systems that insulated our agricultural economy from the rest of the world we were in a much better position to press for rationalization of national agricultural support systems elsewhere. The 1980s have seen us slipping backward. It is more difficult to press others to open their systems to world market conditions when our own has become increasingly insulated.

In the General Agreement on Tariffs and Trade (GATT), the formal system for resolution of trade disputes will be of only very limited relevance to the problems we face in agricultural trade today. Too often we tend to focus on the legalistic system under which trade policies are, or we feel should be, arbitrated. But it is the national and international political and economic climates that primarily affect the outcome of specific disputes. The problems are not border measures but internal programs. The real issue is not a better formula regulating safeguards or subsidies but rationalizing excess price incentives and surplus resources in agricultural production. To begin to address such policies that touch deep-seated political sensitivities, however, will require considerable flexibility and pragmatism.

## A NEED FOR PRAGMATIC AND FLEXIBLE APPROACHES TO SOLVING TRADE DISPUTES

In designing more pragmatic approaches to resolution of trade disputes and rationalization of national systems it is important to understand that the world does not look at trade policy the same way we tend to look at trade policy in North America. Western industrialized countries rely heavily upon an explicit code of law and precedent in the settlement of disputes. The juridical process is readily available to offer remedy to those made victim by others failing to abide by proscribed rules. While rules and procedures govern social conduct in most of the rest of the world, the prominence of such rules and procedures and remedy by litigation is far less prevalent. Practical solutions, consensus building, and unspoken rights and obligations often characterize the dispute settlement process.

I mention this not because I believe that we should abandon rules and procedures in international trade policy but because I feel that improvement in the world trading order must respect the context in which others are approaching the establishment of such rules and procedures. In short, we must build a body of principle but be prepared to seek practical short-term and politically viable solutions to trade disputes. We should have to turn to formal adjudication of such disputes only rarely.

The GATT cannot be a world court of trade disputes. The GATT exists at the pleasure of its signatories. When it was the predominate player in the world economy, the United States had more leverage to impose trade solutions. Today, if the GATT rules are not politically acceptable to national governments they will be ignored and ultimately the GATT as a general body of principal will be eroded.

International systems for dispute settlement can work. As a grain company executive, I observed the successful settlement of numerous disputes over grain contracts. The system of arbitration is based not in international law but by agreement between the private concerns involved to respect the findings of an arbitration panel as binding. It works for very pragmatic reasons. It works because the players realize that to ignore the findings would undermine the overall commercial structure that protects their commercial interests.

Trade policy, however, is rooted not just in commercial interest, but also in a diverse web of internal national political and economic interests. Some of these interests are obvious; many are not. Yet, the complexity of these interests suggests a much more flexible and pragmatic approach than can be fully and successfully accomplished under a formal international process of dispute settlement.

Having said the above, I do think that the GATT needs to be strengthened as a body of principle. I firmly believe that it was a mistake merely to refine the GATT rules as we did during the Tokyo round to accommodate national systems and to attempt to establish elaborate dispute settlement procedures without a consensus on the principles governing trade. For example, Article XVI prohibits the use of export subsidies for manufactured goods. But subsidies on primary products such as most agricultural commodities are permitted insofar as such subsidies are not used to increase a country's market share in that commodity. During the Tokyo Round we were unable to seek rules toward the elimination of agricultural subsidies, primarily because many countries, the members of the European Community, for example, consider export subsidies to be a necessary and continuing element of their price support systems. Therefore, we agreed only to refine the rules by which export subsidies are acceptable, namely the definition of what constituted "increasing market share." By so doing, it could be argued that we sanctioned the continued use of export subsidies for primary products. On the contrary we should be persistently seeking rules prohibiting the use of export subsidies on primary products but with a pragmatism regarding the means by which nations accommodate their own circumstances to such a commitment over time.

A dispute settlement process will be meaningless unless there is broad agreement with the principles against which behavior can be measured. The objective of an improved dispute settlement mechanism in the Tokyo Round was laudable. But with major gaps in the body of principle governing trade disputes the "strengthened" dispute settlement process has resulted in a series of intimidated panel members, ignored decisions, and disillusioned politicians who have seen their fears confirmed that the "GATT is useless." Consensus on principles must be a necessary prerequisite to establishment of dispute settlement mechanisms.

## BUILDING ORDER IN WORLD TRADE

The first step in building a more meaningful world trade order is a set of unambiguous principles. The recent proposal by the U.S. administration to end agricultural subsidies by the year 2000 is a step in the right direction. However, it is not a negotiating strategy. Nor can I envision it being translated into a legalistic code against which trade disputes are litigated, at least in the foreseeable future. It must provide a basis for establishing or strengthening principles that will guide the gradual rationalization of national systems and within a process that respects the political and practical circumstances that negotiators operate. Therefore, we must have unambiguous goals but be flexible in accommodating various means of achieving them, respecting the realities of national systems and political constraints all of us must face.

What, then, can be accomplished in the Uruguay Round of trade negotiations that can contribute to a better basis for dealing with agricultural trade disputes? First, we must ensure that there is a parallel process to the formal GATT negotiations that provides for rationalizing the domestic policies that give rise to the gross imbalances between supply and demand for agricultural commodities in both domestic and world markets. To accomplish this we must seek greater transparency in national support programs so that we have some benchmarks upon which to base a process of rationalizing national systems with world market conditions. Second, we should continue to build on the body of principle within the GATT that describes rights and obligations of nations with regard to international agricultural trade. Third, we must encourage dialogue bilaterally and multilaterally, not within the context of the politically charged atmosphere that has characterized discussions in recent years, but quietly among officials seeking common solutions to trade-distorting policies.

Given the predominant role of domestic agricultural policy in setting agricultural trade policy I do not believe that the process of rationalization of both can be accomplished solely with the GATT process, which deals primarily with the establishment of general rules and the reduction of specific trade barriers. Rather, I believe that a commodity sector approach is likely to be more productive in the short to intermediate term. Such a process should not preclude the GATT rules as they apply to agriculture, but should permit more sweeping short-term rationalization of the domestic policies behind the distortion of world trade.

## Implementation

The work done by the Organization for Economic Cooperation and Development on producer and consumer subsidy equivalents could provide a useful framework particularly in offering greater transparency in levels of support (Organization for Economic Cooperation and Development, 1987; see also Blandford's and Huff's papers, this volume). Restrictions on the level of domestic and export subsidies might evolve from an agreement on existing levels. Rules regarding safeguards should also be addressed.

Sector-specific agreements should not be confused with the commodity agreements of the past. While some elements of such agreements may be appropriate for the rationalization of domestic and export policies, efforts to negotiate around commodities in the past were often characterized by market sharing and export price provisions with less attention to the national policies that caused the imbalances. Attempts to structure artificially the world market will not work. Attention must be focused on national policies.

National political constraints will limit how far negotiators can progress in formal agreements. Continuing efforts will have to be made on a more informal basis to maintain and rationalize agricultural trade and to manage disputes. Too often in the past negotiators have approached trade problems with the intention of proving how tough they can be in maintaining politically popular positions. Today, greater leadership is required of our negotiators to develop processes and solutions that represent realistic long term approaches to essential adjustments rather than political palliatives.

I might describe, for example, a model drawn upon personal experience. During the course of the international grains negotiations during the Tokyo Round, an informal working relationship developed among officials representing the major grain-exporting nations. Bill Miner, Dale Hathaway, and I were involved in building this dialogue, and carried a congenial relationship from the international grains negotiations into regular meetings of policy officials from the nations that dominated grain exports. The Director General for Agriculture for the European Community was also an active participant in these efforts. Through this informal structure many issues were able to be addressed before they became major trade disputes.

It is difficult to judge whether such a constructive working relationship could have survived the increasingly burdensome supply pressures that have characterized the ensuing years, but the degree of cooperation changed with a new administration in the United States and the departure of key officials abroad who had been active in the process. I remain convinced, however, that "people of good intentions" working outside the main political limelight will be far more crucial to finding practical solutions to some of the pressures affecting international agricultural trade than any formal agreement that is likely to be reached.

The pressure mounts for rationalization of agricultural policies throughout the developed world. Both Canada and the United States must provide a large share of the leadership for such change. While our marketing systems differ for many agricultural commodities both countries have a great deal at stake in finding solutions that will permit both to enjoy the considerable comparative advantage each has in agricultural production and trade. Solutions will not come easy, but the burdensome nature of supply imbalances and cost of maintaining current systems are forcing consideration of new approaches throughout the world.

I believe that North American agriculture has a bright future. Yet, the solutions that ultimately are pursued will have profound implications for the timing of recovery of our respective farm sectors. The quicker that countries agree to take the short-term painful adjustments, the quicker will be the eventual recovery. The longer we delay, the longer will be the agony.

I believe that the time is right for comprehensive and pragmatic solutions to rationalization of national agricultural policies and, through such actions, a better structure for the expansion of world trade.

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# CANADIAN-U.S. AGRICULTURAL TRADE: A PROPOSAL FOR RESOLVING DISPUTES

## Debra P. Steger

### INTRODUCTION

In the past few years, the number of agricultural trade actions between Canada and the United States has escalated, affecting a significant volume of trade between the two countries. This development demonstrates that there are serious frictions in our agricultural trading relationship. Although agriculture represents only 4 percent of total bilateral trade, most of the recent countervailing duty and antidumping investigations between the two countries have involved agricultural products.[1] If fish and forest products are included within the rubric of agriculture, then the percentage of trade cases involving agricultural products becomes even more significant.

In these trade disputes, subsidies are the most important problem. Most trade experts would agree that export subsidies have trade-distorting effects and, therefore, should be prohibited. Contention arises, however, over the extensive use in agriculture of domestic or general subsidies, often for important policy goals such as alleviating poverty, redressing unfair imbalances of income, sustaining employment, and eliminating regional industrial, economic, and social disparities.[2]

Under the General Agreement on Tariffs and Trade (GATT) and the Subsidies and Countervailing Duties Codes, domestic administration of countervailing duty laws is sanctioned as part of an international system for disciplining the use of trade-distorting subsidies. As Professor John H. Jackson, a renowned legal authority on international trade, has observed:

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[1] During the 1980-86 period, there were thirteen U.S. countervailing duty investigations of Canadian exports. Of those, nine involved agricultural products. The most significant cases, in terms of volumes of trade affected, were hogs and pork, Atlantic groundfish, softwood products, and softwood lumber. During the 1980-85 period, six of the ten U.S. antidumping investigations of Canadian exports involved agricultural or processed food products (U.S. International Trade Commission, *Annual Report*, various issues; and Office of the U.S. Trade Representative, *Annual Report of the President on the Trade Agreements Program*, various issues). In contrast, during the 1980-87 period, there was only one Canadian countervailing duty investigation involving U.S. exports (of grain corn).

[2] The Subsidies and Countervailing Duties Code, signed as a result of the Tokyo Round in 1979, explicitly prohibits the use of export subsidies--that is, government programs directed at exports or contingent on export performance--except those on certain primary products such as agricultural products. In Article 11 of the Code, however, the signatories recognized that domestic subsidies may be used for beneficial policy purposes and should not be disciplined except where they have trade-distorting or injurious effects. See "Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade," GATT (1979), p. 56.

> even nations with very similar economic systems, such as two industrial country market economies, can find that minor variations in their economic systems can create situations which have the appearance of unfairness. These situations may have arisen almost completely by accident ... when two societies with even minor economic differences desire to work together, frictions or misunderstandings can occur unless there is an interface mechanism (Jackson, 1986).

Jackson suggests that domestic trade laws, when working properly, may perform this interface function, with high administrative costs and strong moral and political overtones. After the recent experience of the countervailing duty cases involving Canadian softwood lumber and U.S. corn, one can reasonably observe that our domestic trade law systems are not working as an interface mechanism.[3] There is substantive disagreement between the two countries on some of the rules, such as the definition of countervailable subsidy. Unfortunately, there also appears to be a corresponding lack of confidence in the ability of our trade remedy systems to apply fairly or interpret the rules as they are understood.

As Robert Hudec has observed, a dispute settlement mechanism will not work unless there is substantive agreement on the rules. It is also essential that all parties involved believe that the system is procedurally fair (Hudec, 1978). In other words, for an international dispute settlement mechanism to be effective, the parties involved must have confidence that the mechanisms they have selected to resolve their disputes are designed to apply fairly or interpret the rules. The softwood lumber case, in particular, demonstrated that Canadians not only disagree with the U.S. Commerce Department's interpretation of the rules, but also that they have lost confidence in the ability of the U.S. system to be fair.

## THE CURRENT SYSTEM

There is a widespread belief among the GATT contracting parties that GATT dispute settlement mechanisms are not working. Professors Hudec, Jackson, and others have chronicled many reasons for the decline of confidence in, and the lack of utilization of, these procedures (see Hudec, 1980; Jackson, 1978, 1979). The U.S. administration, particularly since 1984, has expressed its lack of confidence in the GATT system through pursuing a unilateral policy of reducing trade barriers by negotiating bilateral and multilateral agreements and by aggressively attacking unfair trade practices with the full panoply of U.S. trade laws.[4] Since 1979, the United States has provided its domestic industries with private rights to initiate antidumping and countervailing duty investigations in an administrative system that is mandatory, time limited, and procedurally biased in favor of domestic complainants.[5]

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[3] This is evidenced by the fact that both countries, as a result of the softwood lumber and corn investigations, complained to the GATT that the investigations were not conducted in accordance with GATT rules. In the softwood lumber case, the GATT investigation was formally ended by the negotiation of the Memorandum of Understanding between the governments of Canada and the United States, signed on December 30, 1986, by which the two countries agreed to resolve differences with respect to the conditions affecting trade in softwood lumber products.

[4] This policy was enunciated in the U.S. Trade and Tariff Act of 1984.

The antidumping and countervailing systems of both Canada and the United States were specifically designed to provide fast, effective relief to domestic industries threatened by imported goods that are tainted with unfair trade practices and that have caused, or are likely to cause, material injury to domestic producers (see Steger, 1986). One has only to examine the Omnibus Trade bill currently being considered by Congress,[6] however, to see that the United States has really gone beyond the intentions of the signatories to the Antidumping and Subsidies and Countervailing Duties Codes in its attempts to reduce trade barriers and to attack unfair trade practices throughout the world. Some would suggest that the United States, through administrative and judicial interpretation in specific trade cases and progressive legislative amendments, has created a whole new set of rules that are administered unilaterally by U.S. agencies and courts.

As a result of these recent U.S. actions, there is now serious disagreement between Canada and the United States as to the rules of the game and a corresponding lack of confidence in the fairness of their domestic trade regulatory systems to resolve disputes. These problems stem from a basic difference in perception about what is "fair" and what is "unfair" in international trade. The most serious area of disagreement is in the definition of countervailable or actionable subsidy. As a result of the U.S. Commerce Department's preliminary determination in the softwood lumber case and the legislative proposals currently before Congress, it is clear that U.S. interpretations of specific or countervailable subsidies are becoming increasingly broader.

Although the United States objected strongly to Canada's ruling on U.S. corn, including initiation of formal proceedings in the GATT, it is interesting that Canada's Department of National Revenue (Revenue Canada) found only four out of sixty-four programs investigated in that case to be countervailable. Although the Canadian definition of "subsidy," on the face of it, is much broader than the U.S. definition, Revenue Canada, in its determinations to date, has applied a narrower definition of specific, targeted, or countervailable subsidy than has the U.S. Commerce Department. One reason is that Canada's Special Import Measures Act contains a provision stating that in considering the definition of "subsidy" or "subsidization," Revenue Canada is to "take fully into account Articles 9 and 11 of the Subsidies and Countervailing Duties Agreement" (s. 2(5)).

The primary purpose of the Code, as expressed in its preamble, is to reduce or eliminate the trade-restricting or distorting effects of subsidies and to bring them under more effective international discipline. Article 9 of the Code prohibits signatories from granting export subsidies on products other than certain primary products. Article 11 states that the signatories recognize that domestic subsidies are widely used as important instruments for the promotion of social and economic policy objectives. The signatories agreed that in designing their government assistance programs, they would seek to avoid causing injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory, in particular where such subsidies would adversely affect normal competitive conditions.

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[5] This system was established under the U.S. Trade Agreements Act of 1979. Canada has adopted an essentially similar set of rules and procedures in the Special Import Measures Act. For a basic review of the U.S. system, see Horlick, Bello, and Talbot (1985).

[6] For example, the Trade and International Economic Policy Reform Act of 1987 and the Omnibus Trade and Competitiveness Act of 1987, both passed in the 100th Congress, 1st Session.

## A PROPOSAL IN THE CONTEXT OF A FREE TRADE AGREEMENT

The negotiation of a free trade area agreement provides a unique opportunity for Canada and the United States to develop common rules for regulating the use of subsidies. A critical question in these negotiations is whether the two countries can devise a better mechanism than the current domestic trade remedy systems for dealing with their trade disputes.

What is needed first is substantive agreement on the rules. One option would be to replace existing countervailing duty laws with a new binational system for regulating subsidy practices. It would not be particularly useful, however, to include in a free trade agreement a *statutory* definition of countervailable subsidy, for two reasons. First, as any economist will confirm, it is extremely difficult to develop clear legal principles for determining which subsidies will have trade-distorting effects. Second, any general statutory definition of necessity will be overly broad and subject to interpretation by the agencies or authorities charged with administering the agreement.

A better proposal would be to include a provision similar to Article 92 of the European Economic Community (EEC) Treaty, which declares that government assistance in any form that distorts or threatens to distort competition, insofar as it affects trade between member states, is incompatible with the common market (see EEC, 1973, Articles 92, 93, and 94). The EEC Treaty also provides lists of categories of subsidy programs that are deemed to be, or may be considered to be, compatible with the common market. These lists have been given more substance, over time, by the negotiation of community standards for regional development programs, sectoral programs, research and development programs, and general programs.

Under the EEC system, the European Commission is required to review all existing government assistance programs and to monitor the development of new ones. Member countries are required to notify the Commission of any proposed new programs. The Commission has the authority to review existing or proposed programs and to order a member country to abolish or alter a program. Where a member country does not comply with a ruling of the Commission, that ruling may be enforced in the European Court of Justice.

In preparing lists of categories of programs that are always acceptable and those that may be acceptable, the Canadian and U.S. negotiators might also be guided by Articles 9 to 11 of the Subsidies and Countervailing Duties Code. The basic purpose of any rules developed to regulate the use of subsidies should be to eliminate government programs that distort, or that threaten to distort, competition insofar as they affect trade between the two countries.

Adoption of a binational system for regulating the use of subsidies should be phased in gradually over time. The two countries could agree initially not to create any new trade-distorting programs and to phase out objectionable programs over a period of time sufficient for adjustment to take place. In the transitional period before the new system comes into effect, the domestic agencies responsible for administering trade laws could continue to investigate and determine cases on the basis of domestic laws as supplemented by the new rules contained in the agreement.

It would not be necessary in the context of these negotiations to review all existing government programs and to develop new standards for agricultural subsidy programs before an agreement is concluded. Obviously, the agricultural subsidies dilemma is very complex and requires a multilateral solution. In the Canadian-U.S. context, this subject should be addressed by a specific working group established after a bilateral agreement has been concluded. After there has been some progress on the multilateral front, the two countries could then develop a common policy approach. Economists have already begun to address the question of which types of agricultural subsidy programs should be prohibited, which should be reviewable, and which should be acceptable. Professor T. K. Warley, for example, has developed a red, green, and amber light approach to the problem of categorizing subsidy programs in light of their trade-distorting effects (Warley, 1987, and contribution to this volume; see also the paper by W. M. Miner in this volume).

In a free trade area, injury determinations would become unnecessary in subsidy cases for the same reason that many economists have argued that antidumping restrictions would be redundant: in the absence of separate, divisible markets, the concept of injury to a domestic industry no longer makes economic sense. Instead, the standard should be the effect of a subsidy program on normal conditions of competition in, and trade between, the member countries.

The second aspect of this proposal would be to establish a binational agency responsible for administering the rules. A free trade area agreement will include new obligations and rules concerning subsidies, dumping, restrictive business practices, protection of intellectual property, government procurement, product standards and technical regulations, trade in services, and investment. Given the complexity and comprehensive scope of the proposed agreement, and its importance in ensuring and expanding market access for private businesses in an integrated North American market, it is crucial that an appropriate joint mechanism be established to administer the agreement, to monitor legislative and policy developments as well as the activities of private firms, and to assist in resolving disputes. Even if the negotiators do their best to create objective, effective rules, there will be areas where the rules are ambiguous and require elucidation. Also, as economic and political conditions change over time, a joint mechanism will be required to interpret and apply the rules and to propose legislative adjustments to the member governments.

An *ad hoc* panel procedure such as the dispute settlement mechanisms of the GATT will not provide the certainty or continuity required for the administration of a free trade area agreement. What is required is a permanent, independent, joint institution with administrative, adjudicative, and legislative capabilities. An existing example of such an institution is the International Joint Commission (IJC), established under the Boundary Waters Treaty of 1909 between Canada and the United States.

The free trade agreement should also include a "transparency requirement." Either country should be required to notify the binational agency of its existing programs and any new programs it proposes to implement. The agency should be given the authority to review proposed domestic programs, to consult with the two governments, and, where necessary, to issue orders declaring that certain programs are incompatible with the objectives of the agreement. The object of this process would be to achieve, in a neutral binational forum, a balance between legitimate national policy goals and a minimization of market distortions. There should also be a procedure whereby the Canadian or U.S. government could apply to the agency for a preliminary review of a proposed assistance program and a waiver or exemption in exceptional circumstances.

To the extent that an agreement contains extensive new rules governing the use of subsidies, a permanent, quasi-judicial tribunal should be established, as part of a binational agency, for resolving certain types of disputes, particularly those affecting private parties.

The tribunal's determinations should be based on the rules of the agreement and be delivered expeditiously after a neutral, objective investigation of the facts. Its rulings should be "binding" in the sense that they should be final and effective in resolving disputes. This does not mean that its decisions should be enforceable in the two countries' domestic courts or in an international court created or approved by the two countries. If either country fails to abide by a clear, objective ruling, the other should be able to retaliate after obtaining approval and specific directions from the tribunal. In other words, where one party ignores an order of the tribunal, the other party may apply to the tribunal for a declaration that the offending party has failed to comply and for directions as to an appropriate retaliatory remedy. As the objective is to develop a rules-oriented system for resolving disputes in the free trade area, the tribunal should be empowered to grant enforcement orders providing for retaliation by the injured party.

Over time, the tribunal's rules-oriented determinations will improve the predictability and reduce the number of significant trade disputes between Canada and the United States. Allowing private parties, as well as local, state, and provincial governments, access to the tribunal will help deflect and defuse protectionist pressures on the two federal governments. If the agency is to be a credible institution improving bilateral economic relations, it must be able to provide neutral, objective advice, and it must be given explicit authority to adjudicate disputes, particularly those affecting private interests, and to make effective determinations based on the rules.

## CONCLUSION

Achieving agreement on the regulation of agricultural subsidies will be a difficult task. Developing specific standards for agricultural subsidies will be particularly complex and may not be achievable until after significant progress is made in the Uruguay Round of multilateral trade negotiations. It is customary for new rules established in a free trade area agreement to be phased in over time to avoid serious dislocation and adjustment difficulties. During the transition period, the domestic agencies that currently administer trade laws will continue to do so, taking into account the new rules contained in the agreement.

The binational agency should also be established over a transitional period--say, three to five years--and gradually take over responsibility for administering the agreement from the various domestic agencies. It should appoint working groups to develop detailed agreements on the ground rules for acceptable government programs in areas such as regional development, agriculture, research and development, and the environment. These working groups should also be responsible for making proposals to the U.S. Congress, the Canadian Parliament, and provincial and state legislatures to modify existing Canadian and U.S. trade laws and to replace them in a ten-to-twelve-year transitional period with harmonized legislation.

There can be no effective international discipline of the use of agricultural subsidies, however, without multilateral agreement. Thus, the bilateral agreement could provide an option for allowing other countries to join in the Canadian-U.S. dispute settlement mechanism. Although a great deal of study is required to develop standards for agricultural subsidies, establishing a binational system for the regulation of subsidies would be a first step in achieving harmonization of Canadian and U.S. agricultural programs. It would ensure security of access to our respective markets for our agricultural exports.

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# LINKAGES BETWEEN BILATERAL AND MULTILATERAL NEGOTIATIONS IN AGRICULTURE

T. K. Warley

## INTRODUCTION

Canada and the United States are both at present involved in two sets of trade negotiations that involve agriculture. Indeed, in the Uruguay Round of the multilateral trade negotiations (MTN) agriculture has been singled out as a sector in which significant changes are needed. It is the oft-expressed hope of many that the Canadian-U.S. bilateral trade negotiations (BTN) will serve as a model for the MTN, particularly in agriculture. The U.S. agricultural negotiator, Leo Mayer, specifically mentioned this expectation in his presentation at this conference. Yet among observers of both sets of negotiations there are those who emphasize the differences between them. Most importantly, they argue, it is unlikely that either Canada or the United States will give up in a bilateral agreement agricultural subsidies provided through domestic programs that may provide valuable negotiating leverage in the MTN. They point out also that in bilateral trade agriculture is a relatively small component of the total, and that the commodities that will be of primary importance in the MTN, grains and oilseeds, are not traded between Canada and the United States to any great extent. Finally, they note that it has been Europe and Japan that have been the main targets of both countries' agricultural and commercial diplomacy, not each other.

These arguments, however, neglect the many important linkages that exist between the two sets of negotiations, both in the broad common interests and in the finer details of particular issues.

The most important of these is the "demonstration effect" the BTN can have for the MTN. It is decisively important to both the United States and Canada that they send the right signals to other countries on the liberalization of agricultural trade. This means that they must show clearly and unequivocally that they can open continental trade in farm and food products, both by changing those elements of national agricultural policies and programs that harm the legitimate trade interests of the negotiating partner and by removing frontier measures such as tariffs, quotas, and technical restrictions. Furthermore, providing the right demonstration effect requires that continental agricultural trade liberalization be on the widest possible scale with few exceptions.

The BTN also offer the United States and Canada the opportunity to develop a common stance, which they can then take to the MTN. Both countries have much to gain from evolving mutually supportive MTN negotiating positions. In particular, the reality of the distribution of influence means the results for Canada of the MTN will be augmented if Canada can support negotiating approaches favored by the United States. By the same token, the negotiating proposals of the United States would be strengthened if they were supported by an important member of the Cairns group.

Third, the specific issues that will be confronted in the BTN will also be on the table in Geneva. The negotiations between Ottawa and Washington provide a testing ground for alternative approaches and prototype solutions to specific issues, some of which may be subsequently adopted multilaterally. Among the key issues that will be discussed will be subsidies and access, technical barriers to trade, state trading, the problem of persuading subnational governing bodies to adhere to agreements negotiated by national governments, and institutional arrangements. At a minimum, having to address these matters early means that both countries' negotiators will enter the agricultural component of the MTN exceptionally well prepared.

## SPECIFIC ISSUES OF INTEREST IN BOTH THE BILATERAL AND MULTILATERAL NEGOTIATIONS

### Access and Subsidization

Providing improved and assured access to import markets for efficient suppliers and ending the subsidization of high-cost production and of exports are, of course, the very essence of both sets of negotiations. It is common to address access and subsidization separately, but they are, in truth, usually but too sides of the same coin. The U.S. proposal presented to the General Agreement on Tariffs and Trade (GATT) negotiating group on agriculture on July 6, 1987 in fact deals with access and subsidization simultaneously by calling for the "elimination of all forms of support and protection for agricultural production ... world-wide" (Office of the U.S. Trade Representative and U.S. Department of Agriculture, 1987). National subsidies for agriculture and import barriers would be phased out over a ten-year period; the volume of exports that enjoy subsidies would be frozen initially, then they too would be phased out over ten years. Phytosanitary regulations and barriers would be harmonized among countries, using standards that were internationally acceptable (Office of the U.S. Trade Representative and U.S. Department of Agriculture, 1987). The United States has proposed that to meet the objective of reducing agricultural subsidies an aggregate measure be used that quantifies the amount of support given to agriculture through various government programs. The measure they have suggested is the producer subsidy equivalent (PSE) (see Blandford's and Huff's papers in this volume), but they do leave some leeway for other measures (Office of the U.S. Trade Representative and U.S. Department of Agriculture, 1987).

### *Access*

In the preparatory work for the MTN centered in GATT's Committee on Trade in Agriculture (CTA), discussions on market access appear to have focussed on improving the operational effectiveness of Article XI by such means as permitting the use of quantitative import restrictions only where national output is effectively constrained and by extending the use of quantitative minimum access commitments (General Agreement on Tariffs and Trade, 1985).[1] Additionally, it could be anticipated that exporters' access to import markets would be improved by use of the traditional request and offers technique.

This two-element approach to access in GATT--strengthening GATT's rules and disciplines and the reciprocal exchange of specific concessions--was never very promising for it does not address in a direct and radical manner the need to change the national farm programs that impair access by subsidizing import displacement. This whole approach is now, however, a moot point following the U.S. proposal.

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[1] Article XI calls for the general elimination of quantitative trade restrictions.

In the BTN the goal of improving access to the United States and Canadian markets is being pursued essentially on a request-and-offer basis, except that there is the possibility of agreement to eliminate all tariffs on farm and food products over a ten-year period. Accordingly, it would seem that, at this stage, the BTN have little to offer the MTN on the issue of access. The U.S. GATT proposal addresses the fundamental cause of the access problem and in a direct way, while the BTN are using an unpromising technique to pursue limited objectives.

### *Subsidization*

The U.S. negotiating proposal also comes at the problem of subsidization more directly than the approaches being followed in either the MTN or the BTN prior to July 6.

In the CTA the issue of subsidization was addressed primarily by identifying ways in which the legal precision and the application of Article XVI of the Agreement and the Tokyo Round subsidies code could be clarified and strengthened.[2] In the BTN the approach to subsidization has been shaped largely by Canada's anxiety to obtain a clarification of what was a countervailable subsidy.

The U.S. GATT proposal to use producer subsidy equivalents as a basis for the establishment and verification of quantified and legally binding obligations to reduce the level of agricultural subsidization deals with access and subsidization simultaneously, and in a manner which goes far beyond anything conceivably accomplishable by requests and offers, rewriting Articles XI and XVI and the subsidies code, and defining what constitutes a countervailable subsidy. And whereas discussions on subsidization in the CTA had concentrated largely on export subsidies and discussions in the BTN on domestic subsidies to exported products, the U.S. proposal embraces export and domestic subsidies simultaneously. Furthermore, it addresses two aspects of subsidization that are important in the U.S.-Canada bilateral relationship but which the two countries have had difficulty in coming to grips with in the BTN: these are the issues of subsidized import substitution in national markets and subsidized export competition in third country markets.

### *Bilateral-Multilateral Intertwinings*

While the BTN seem to have little to offer the MTN on agricultural trade on the two pivotal issues of access and subsidization, there are still three ways in which both sets of negotiations on these issues could be related.

Some elements of a bilateral agreement on agriculture will be worked out and phased in over time. First, provided Canadian authorities shared the bold objective expressed in the U.S. MTN proposal on agriculture, and if they can be persuaded that an approach based on the PSE was feasible and desirable, it could be stated in the bilateral agreement that the two countries would progressively fold their continental accord on agricultural subsidization and trade into the framework of a multilateral agreement should such an agreement be concluded in the Uruguay Round. The use of the PSE in the definition of bilateral obligations would reinforce consideration of a formula approach to agricultural policy and trade reform in the MTN.

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[2] Article XVI covers subsidies, discouraging them in general and calling, in particular, for the elimination of non-primary product export subsidies. For primary products, export subsidies should not enable a country to capture more than an equitable share of world export trade in the product. The subsidy code establishes criteria to distinguish between domestic and export subsidies. Current rules allow export subsidies for agricultural products while they are prohibited for other products (Congressional Budget Office, 1987).

Second, there is obviously a coincidence between the need to define in the MTN which national agricultural programs constitute trade distorting subsidies (and which should, therefore, be included in PSE calculations) and the Canadian desire to obtain agreement in the BTN on what is a trade-distorting (and therefore countervailable) subsidy. Progress in either negotiations will advance the work in the other. Further, as is explained below, two particular issues that are central in the BTN will inevitably become crucial in the MTN: these are to identify the trade effects of stabilization and supply management programs. The early experience of dealing with the trade impacts of these programs in the BTN can only be helpful to their treatment in the MTN.

Third, despite its many attractions, it is no secret that elements in both Canada and the United States--particularly in their Departments of Agriculture--have substantive reservations about the use of the PSE as a basis for trade negotiations (de Gorter and McClatchy, 1984; McClatchy, 1987; U.S. Department of Agriculture, 1987). Furthermore, even proponents of the technique readily acknowledge that it has important limitations (Tangermann, Josling, and Pearson, 1987). The difficulties with using the PSE as a basis for trade and policy obligations include the following. There is no agreement on the programs that should be included in the calculation of PSEs. The PSE is generally a poor proxy for the trade distortions caused by national agricultural programs. The diverse trade effects of alternative forms of policy instruments are not well measured; in particular, supply management techniques and shared risk programs are not satisfactorily handled. A country's PSEs--and presumably therefore its policy obligations--can be changed by other countries' behavior, particularly through changes in exchange rates and in the instrumentation and parameters of large countries' farm programs. Large-country effects are generally neglected. Cross-commodity effects have not been fully established. The effect on PSEs of policy-inflated input prices have not always been clarified. It is not clear whether the effects on trade that flow from consumption distortions should be included, and in what manner. The choice of world reference prices and base periods against which to measure national PSEs is a practical matter of great consequence. And the flexibility available to countries on the choice of commodities and instruments to include in the fulfillment of their bound obligations to reduce PSE levels is a negotiable variable also.

This litany of problems that attends the proposal to use the PSE in the agricultural MTN suggests that experimentation with the technique in the bilateral trade arrangement might be helpful. Equally, the use of alternatives to the PSE might be explored.

### *Possible Alternatives to PSEs*

There are plenty of candidates. Ostensibly simpler measures are the "nominal rate of protection," the "nominal rate of assistance" (equivalent to the "price adjustment gap" favored by Australia (Miller, 1986; Haszler and Parsons, 1987)), "producer incentive equivalents" (i.e., only those components of PSEs that have a net influence on output (Rausser and Wright, 1987)), and the "aggregate value of support" (i.e., the product of the unit value of support and the volume of production entitled to receive support (McClatchy, 1987; Hathaway, 1987)).

Going the other way, there are quantitative indicators that attempt to measure directly (rather than to infer) the distortions in world markets actually produced by national farm programs. These include the "rate of (price) distortion" (de Gorter and McClatchy, 1984), the "trade (volume) distortion effect" (McClatchy, 1987), and conceptually at least, the output of partial and general equilibrium world trade models (e.g., Tyers and Anderson, 1986; Parikh and coauthors, 1987; Trella, Whalley, and Wigle, 1986). The latter models also provide information on income distribution and economic welfare effects.

The exploration of alternatives to the PSE that might be initiated bilaterally should be constrained by the observation that it probably does not matter much which measuring device is used if there is a genuine and effective multilateral agreement to reduce protection to zero. On the other hand, if there is agreement only on some less ambitious target, or the reduction in protection is to occur over a relatively long period, then the measurement technique chosen may matter a great deal.

### *The Question of Inclusion*

In using all these measures to fix, and to monitor progress towards, domestic support policy changes and more liberal trade arrangements, the key question is which policy instruments should be included in the measure-based obligation to reduce and remove assistance. One of the matters that is central in the BTN and will become so in the MTN is whether agricultural "stabilization" programs are trade distorting. If they are, they should be countervailable in bilateral trade and included in PSE-based MTN obligations. Most Canadians would argue that programs of the type operated under the federal Agricultural Stabilization Act (including the tripartite variant), the Agricultural Products Board Act, and the Western Grains Stabilization Act have so small an effect on production and consumption as to be for all practical purposes trade-neutral. They would therefore contend that payments under these programs should not be treated as countervailable subsidies in a Canadian-American Free Trade Area (CAFTA) or abandoned in the reform of agricultural policies under a GATT accord.

In testing this contention, first in the BTN and subsequently in the MTN, it will be imperative to be absolutely clear on the characteristics of these beneficial "stabilization" programs that differentiate them from trade-distorting "support" programs. First, their main purpose is to enhance allocative efficiency by correcting for a pervasive failure of agricultural commodity markets--dysfunctional instability--rather than to increase agricultural factor returns. Second, they provide only low-slung economic safety nets to producers, and the levels of those safety nets are market-determined. Third, payments are sporadic and retrospective. Fourth, producers contribute a significant proportion of the monies required by stabilization funds and, over time, these funds are expected to be actuarially sound. Finally, stabilization arrangements with these features are generally available to agricultural producers, albeit details can be tailored to the production and market characteristics of individual commodities. In short, the concept is not fundamentally different from that envisioned by the present U.S. administration as being the modest stabilization role to be fulfilled by loan rates for the basic crops at the end of the term of the 1985 Food Security Act (Glaser, 1986). If they could be devised, more general farm income insurance programs would be even more acceptable internationally since such schemes would be explicitly "decoupled' from commodity markets and production decisions.

A second Canadian contention made in the BTN and likely to be tested in the MTN is that national supply management programs (that produce huge income transfers, as shown by large PSEs) may not distort trade so long as imports satisfy their presubsidization shares of national consumption. They may indeed contribute to international market stability. U.S. authorities will likely find merit in this argument since the United States will want negotiating credits in the MTN for the set-aside, storage and diversion programs it operates for grains.

## Technical Barriers

Agricultural technical regulations, standards, and certification procedures as they apply, *inter alia*, to human, animal, and plant health, product safety, and deceptive practices are important impediments to trade in farm and food products. They are on the agenda of the BTN, and both the Uruguay Round Ministerial declaration and the U.S. negotiating proposal call for a reduction in the adverse effects on trade of phytosanitary regulations.

There is an obvious way to go about this task. The stages are, first, the articulation of a coherent set of principles that should guide the use of national regulations; second, the elimination of inherited trade-hindering regulations that no longer serve any useful technical purpose; and, third, the negotiated harmonization of separate national regulations and standards. This was precisely the process initiated in the Agreement on Technical Barriers to Trade negotiated in the Tokyo Round (General Agreement on Tariffs and Trade, 1979).

The kind of principles that were spelled out in the 1979 Agreement are presumably equally applicable in the BTN. They include commitments not deliberately to use technical regulations as concealed protection; to use transparent procedures in setting and enforcing regulations and standards; to adopt existing international regulations and standards wherever feasible; and to accept equivalence in national inspection and certification procedures. Beyond that, it is necessary for national representatives to sit down together to identify and inventory all technical barriers to trade, to agree to remove those that are no longer required and, finally, to go as far as possible in harmonizing those regulations, standards and procedures that most seriously hinder trade.

Happily, this approach is being followed in the BTN, and bilateral success will encourage similar endeavors in the MTN.

The two largest bilateral agricultural trade flows are of animals and red meats and fruits and vegetables. In animal agriculture, particular significance will attach to the ability of Canada and the United States to relax animal health regulations and agree to reciprocal acceptance of each other's meat inspection systems. A second bellwether test of the ability to make progress in the area of regulating technical trade barriers will be provided by the U.S. request that Canada remove the barriers to trade in fruits and vegetables that have strong protective effects but no basis in health and safety concerns. These include restrictions on consignment selling, packaging, can sizes and bilingual labelling.

## State Trading

State trading agencies are proliferating on both the selling and the buying sides of markets for farm and food products (McCalla, 1981). Their behavior in the international trading system is not effectively channeled in market-oriented directions by Articles XI, XVI, and XVII of the GATT, and the effects of their behavior on commodity markets is poorly understood.[3] Hathaway (1983) has pointed out that there cannot be truly open markets for agricultural products until the behavior of such agencies is made more transparent and constrained by operationally effective international rules and disciplines.

This matter has come up in the BTN insofar as the United States has expressed concerns over the licensing system operated by the Canadian Wheat Board (CWB) for imports into Canada of wheat, oats, and barley and their products (other than oats and barley for feed purposes) and the competitive practices of the Board in selling grains in third markets. Both topics--import restrictions operated by state trading agencies and the transparency of the behavior of importing and exporting state and parastatal agencies--will also be addressed in the MTN.

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[3] According to Article XVII, state-owned enterprises should use normal business considerations with respect to price, quality, and procurement when choosing among potential suppliers and customers (Congressional Budget Office, 1987).

It is not, however, apparent how the two sets of negotiations will interact on this issue. This is because there appears to be a disjuncture between the issues and the location of their discussion. Grain import licensing by the CWB is clearly an issue for the BTN, and is simply a component of the wider task of improving access to continental markets. The transparency of the CWB's behavior (particularly with respect to pricing) in selling into the third markets is a subject that is neither easily nor properly confronted in bilateral negotiations--though U.S. authorities are attempting to do so--and is best left to a wider accord in the MTN.

## Adherence to Agreements: National-Subnational Conflicts

An important problem perplexing negotiators in the BTN is that of committing subordinate levels of government to observe agreements entered into by national authorities.

As Garth Coffin described earlier in this conference, jurisdiction over agriculture in Canada is divided between national and provincial governments. The provinces have been extending the reach of their agricultural programs, particularly in the areas of price and income support and stabilization, and many technical regulations and standards fall within the orbit of provincial regulatory authorities. (U.S. states generally have much less influence on agriculture and thereby on agricultural trade, but instances are readily found, particularly in the field of technical regulations.) Given this situation, an important issue in the BTN is how the government of Canada can provide assurances to the United States that provincial authorities will observe and will not subvert specific provisions of a trade agreement.

There is a parallel problem in the MTN. A large proportion of the contracting parties to the GATT are federal states in which the same issue will arise. But the major problem is posed by the European Economic Community. The Community enters into trade agreements but the member states have a large influence over the observance and implementation of their provisions. Specifically, in agriculture, the member states' national expenditures are about as large as Community expenditures on the Common Agricultural Policy (CAP), and the drift of the times seems to be toward "renationalizing the CAP." Furthermore, member states still have great influence over agriculture and food-related technical regulations which, as has been noted, can constitute effective barriers to trade.

This is obviously a problem common to the two sets of negotiations, but how it is to be resolved and the nature of the interaction are not known to this author.

## Institutional Arrangements

Another common area between the BTN and the MTN is the need to create institutions through which the process of liberalizing international trade in agriculture and reforming national agricultural policies can be managed. "Management" involves mechanisms for notification, consultation, harmonization, fact-finding, monitoring, confrontation, interpretation, and dispute settlement on matters large and small.

This topic is explored in this volume by W. Miner, but it seems appropriate to draw attention to two aspects of it that are of particular importance. First, the process of liberalizing agricultural trade by changing national agricultural policies and programs clearly requires the creation of an on-going mechanism for monitoring fulfillment of negotiated obligations. Beyond that, however, there is need for a mechanism by which countries can exercise a *droit de regard* over the purposes, parameters and instrumentation of their trade partners' agricultural policies and assess their compatibility with both legal obligations and consensual standards. Such a mechanism would foster the incorporation of other countries' interests into national decision making about agriculture and enhance the complementarity between national and international actions. Some kind of joint consultative committee on agriculture might emerge from the BTN. In the MTN the purpose might be served by strengthening and continuing the Committee on Trade in Agriculture. Secondly, there is an excellent chance that the BTN might result in important innovations in the area of dispute settlement which might contain useful examples for the MTN, albeit that the bilateral arrangements are likely to be far more ambitious than anything accomplishable in the GATT. Thus the BTN may lead to a binational body with powers of binding arbitration on trade disputes. Developments in this direction could point the way towards badly-needed improvements in GATT's dispute settlement mechanisms and procedures (U.S. Department of Agriculture, 1985). Similarly, many Canadians believe that the BTN should lead to improvements in the application of the contingent protection provisions of national trade laws. Candidate improvements would include the setting of higher standards of proof of causality and injury, requiring a higher *de minimis* level of the jury, and acceptance of the principle that countervailing duties should equal only the net differences in national subsidy levels. Developments such as these would strengthen the operation of the GATT system if embraced in the MTN, not least in trade in agriculture.

## A COMMON VISION

It is apparent that the process of liberalizing continental and international trade in agriculture entails dismantling those components of domestic agricultural policies and accompanying trade arrangements that distort trade by changing national production and consumption (and thereby net import requirements and net export availabilities) and the competitive relationship between domestic and foreign producers. Canada and the United States are committed to this course in both sets of negotiations.

The corollary of abandoning the trade distorting program elements in agricultural policies will be the emergence of a residual set of programs that are nationally beneficial and yet internationally acceptable because they do not distort (though they may in the long term affect) production, consumption and trade. The final suggestion to be made here is that it would be internationally and domestically useful to identify jointly an acceptable agricultural program set for countries with modern agri-food sectors. In bilateral negotiating terms, this exercise would help meet the Canadian need for clarification of what constitutes a countervailable subsidy. In terms of the MTN, it would help establish what should be included in calculated PSEs and PSE-based obligations. Also, it would go some way towards the intention expressed in the Punta del Este declaration to consider "basic principles to govern world trade in agriculture" (General Agreement on Tariffs and Trade, 1986).

Candidate components of such a policy set include the provision of public goods (research, extension, education, market intelligence, grading and inspection services, health and safety standards, physical infrastructure, etc.); development programs (commercial diplomacy, market development, development cooperation, resource and rural development, etc.); programs that correct for market failures (producers' marketing organizations, market-neutral stabilization programs, resource conservation, etc.); and such other programs as adjustment assistance and decoupled rural social income payments.

The specification of such an internationally acceptable national agricultural program set would also help governments domestically in dealing with their farmer constituents in the course of moving public agri-food policies in more market- and trade-oriented directions. And, in the final analysis, this, of course, is the central common task that links the bilateral and multilateral agricultural negotiations.

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# DISCUSSION: LINKAGES BETWEEN BILATERAL AND MULTILATERAL NEGOTIATIONS IN AGRICULTURE

## Dale E. Hathaway

One expects that a paper on trade policy by Professor Warley will be inclusive, insightful, and persuasive. This paper does not disappoint in any regard and, therefore, I have little to criticize in it. Instead, I would like to pick up on several of his points and expand on some of them.

Professor Warley politely fails to mention the first principle of bilateral negotiations occurring during a period of multilateral negotiations: never give away anything in the bilaterals that you might get credit for in the multilaterals.

If one applies this principle, it is immediately apparent that many issues will be ruled out of the bilateral talks because of their importance to the multilateral talks. This assumes that both sides understand and agree as to what the multilateral talks are about. Therefore, I think it is useful to review what they are and are not about.

The GATT (General Agreement on Tariffs and Trade) rules for nonagricultural industries are basically restrictions on the policy instruments that countries can use to protect or assist their domestic industries and the conditions under which they can use these instruments. But agriculture is different. It is different because the rules for agriculture, in essence, now say that any policy instruments are allowed as long as the outcome is agreeable to the contracting parties. Thus, GATT disputes over nonagricultural issues have hinged on whether a particular policy instrument is compatible with the GATT, whereas agricultural disputes have been largely over whether the use of the instruments has been "fair." Since fairness, like beauty, is in the eye of the beholder, major contracting parties have been dissatisfied with the GATT's agriculture rules.

Now, for the first time, countries are engaged in agricultural negotiations over which policies are acceptable--that is, which policies are sufficiently trade distorting to be banned or used only with specific restrictions. This markedly changes the nature of the negotiations in ways that are still uncertain; as a result, it also changes the nature of bilateral talks that are normally a part of the multilateral talks.

It is my belief, based on discussions with policymakers in a number of key countries, that the nature and implications of these changes are not yet understood by most of those responsible for the negotiations. Traditionally, multilateral negotiations have consisted of a series of simultaneous bilateral negotiations. Thus, a negotiation such as the one now under way between Canada and the United States would have fitted neatly into a traditional round of multilateral negotiations, and we would hardly have needed this session.

In order to understand the difference, I think an econometric analogy is relevant. Traditionally, bilateral negotiations have been like a series of independent equations, one for each commodity, where the dependent variable is the expected trade gain and the independent variables are the requests and offers of individual countries. The parameters of the independent variables are known, or believed to be known, reasonably well. A satisfactory outcome is when the sum of the expected trade gains exceeds zero. One reaches this result by not allowing larger negative results for any economically or politically important commodity and by producing at least small positives for a large number of economic interests.

The multilateral negotiations are like a large system of simultaneous equations in which the dependent variable is the net gain in welfare for the entire agricultural sector and the independent variables are the net effects of all the policy changes in all other countries.

There are, unfortunately, two problems with this approach. One is political: is a positive outcome enough? In other words, would big gains in grains and oilseeds and big losses in dairy and sugar be acceptable? The second problem is even more crucial. No one knows the parameters of any of the independent variables! Thus, one cannot even calculate the outcome of various changes, let alone persuade the various constituents that they are in their favor.

It is in this context that one should evaluate the U.S. proposal, including the use of producer subsidy equivalents (PSEs).

The United States has formally proposed that all government policies that intervene in agricultural markets be phased out. The least one can say is that the proposal is comprehensive, simple, understandable, and logical. It is, however, probably not politically feasible. Therefore, it is useful to consider what may be politically possible and view the bilateral talks in that context.

Even though I believe the choice of PSEs as a measuring instrument is unwise and unfortunate, I do understand why it appeals to those wanting to use the U.S. approach. While I doubt anyone in the U.S. government has thought it through, the U.S. approach attempts to deal with the huge political-economic equation involved.

The U.S. approach suggests that PSEs can be used in three ways: (1) as a measure that picks up all the various programs that interfere with agricultural trade (the parameter issue), (2) as a measure of performance that can be monitored (changes in parameters), and (3) as a measurement of reciprocity and success (the dependent variable issue). It does not require a very sophisticated econometrician to realize this does not compute--economically or politically.

For all of the reasons Professor Warley points out, and some others, PSEs do not meet the needs of the negotiations to measure the effects, the policy changes, or the outcome. But they are the best known (and least understood) of the measures commonly available, and they have the blessing of at least one major international organization--the Organization for Economic Cooperation and Development. Given the time and effort agricultural bureaucrats around the world have devoted to understanding and computing these PSEs, it is probably too early to abandon them for some relevant measure that ministers of agriculture and trade can understand and sell to their constituents.

In this context, it is clear why the two sets of negotiations do not mesh. The Canadian-U.S. negotiations are working on different variables and aiming at different outcomes than are the multilateral negotiations. I do not believe that Canada and the United States should spend much energy on trying to sort out the issues that are being addressed in the GATT talks. Nor do I believe that the relative success or failure of the bilateral negotiations should be viewed as sending major signals to the rest of the world about the probability of success or failure of the GATT talks on agriculture.

Having provided this sweeping generalization, I want to point out a key exception. There is one issue on which Canada and the United States can make significant progress that can lead the way in the multilateral negotiations. This is in the area of technical, health, and sanitary regulations that amount to important trade barriers. As one who has had trade policy and trade-negotiating responsibility, I can assure you that policymakers experience no greater frustration than that of trying to deal with veterinarians, and with specialists in plant, animal, and human health. By comparison, elected politicians are open-minded paragons of clarity and cooperation.

These restrictions are important; working out procedures to remove them satisfactorily is as important as the technical details of the final outcome. Here is a case where the joint Canadian-U.S. experience, if successful, could lead to a useful result in the multilateral negotiations.

In looking at the overall context of trade negotiations, I would have to say that we are doing it backwards, as is often the case. Ideally, we should complete the GATT talks, settle all the issues that Professor Warley correctly points out are important, and then negotiate to free trade between our two countries. But these are political negotiations, and political negotiations take place in the real world, not the ideal world. Therefore, I am neither surprised nor disappointed that the bilateral negotiations are using "discredited" techniques to pursue "limited" objectives, as Professor Warley has termed the process. We live in a two-track world; the bilateral track is visible, but the multilateral track is not, and will not be for some time to come.

# DISCUSSION: IS BILATERALISM POSSIBLE?

## Timothy C. Mackey

I have had the benefit of reading the draft paper presented earlier by Professor Warley. It is an excellent discussion of the current situation and I can find very little in it with which to disagree. It is certainly true that bilateral negotiations such as those between Canada and the United States can assist the multilateral negotiation process so long, of course, as the arrangements made in each case are compatible. Although my remarks will naturally be from an Australian perspective, I speak for myself and not the Australian government. We have watched with close interest the negotiations on a free trade agreement between the United States and Canada. You are important trading partners for us, and, more broadly, what develops here will influence, for better or worse, the progress of the multilateral trade negotiations (MTN), on which we are placing so much importance. Australia is one of the countries most aware of the linkages between bilateral and multilateral negotiations in agriculture. We are heavily dependent upon agricultural exports. Exports account for 13 percent of our gross national product (GNP), and agriculture makes up around 40 percent of our total exports, compared to around 8 percent in both the United States and Canada. Eighty percent of our wool is exported, 85 percent of our wheat, and 70 percent of our sugar (Australian Bureau of Statistics and Department of Trade). We do not have in place, for our major agricultural exports, subsidy programs that interfere with world price signals. When prices fall, so do our farmers' incomes. Our farm price for wheat this year is around US$1.70 per bushel.

As we consider agriculture in the trade negotiations, both the U.S.-Canadian bilateral talks and the MTN, two themes stand out as being of particular importance. One is that of the integration of world economies--very few agricultural markets now operate in isolation. Action taken in one place will almost certainly have impacts elsewhere. The other theme is timeliness or, more bluntly, the need for early action on agricultural trade issues.

### INTEGRATION OF WORLD ECONOMIES

Of necessity we have learned how difficult it is to separate out parts of the world agricultural trade economy and try to deal with them individually. As with the human body, changes to one part of the world economy inevitably affect all the others. It may well be impossible to deal with solutions to trade problems on anything other than a multilateral basis.

Let me give some examples of the difficulty of containing the effects of agricultural protectionism. I use sugar as the first example. The European Community (EC) over a period of years changed from being an importer of sugar to become a large subsidized exporter. Partly in defense, the current U.S. sugar program was instituted, wherein U.S. farmers receive very high sugar prices and there are stringent quotas on imports. A clear consequence of this policy has been that sugar has been priced out of the domestic market for many uses by competition from corn sweeteners. Although U.S. sugar production has increased slightly, imports have fallen dramatically since 1981. As a result, a number of U.S. sugar refineries have closed, and many others are operating at less than full capacity. The drop in imports following the imposition of country-by-country import quotas in 1982 has hurt countries like Australia and Canada. Australia's import share has gone from 800,000 tons in 1981 to under 70,000 tons in 1987 (International Sugar Organization, 1987). Not only have developed countries been affected, but developing countries such as the Dominican Republic and the Philippines have also lost export income that formerly came from sugar exported to the United States. Countries such as these are potentially good customers for agricultural exports, such as U.S. grain, but this potential can only be realized if they can earn export income themselves.

A further consequence of the sugar program and the increased production of corn sweeteners has been that the United States is now an economic producer of corn gluten, huge quantities of which it exports to the EC. The EC in turn claims that, because of these large gluten imports, it must dump feed grains on the world market--much to the chagrin of Australia, Canada, and the United States.

Another example is wheat gluten. Gluten is a byproduct from the manufacturing of agricultural products and is affected, often in an unforeseen way, by programs intended only for the primary product. Australia and Canada are efficient producers of wheat and wheat gluten. Australia is currently a significant unsubsidized exporter of wheat gluten to the United States. Once again, with the help of export subsidies, the EC has become a large exporter of wheat gluten and is starting to increase its market share in the United States. No doubt pressure will arise in the United States to restrict these imports. But if U.S. imports are restricted across the board, other exporters will be affected.

Faced with this scenario, what does an efficient producer of wheat gluten in a country such as Australia or Canada do? One obvious step is to become a wheat gluten producer in the EC or the U.S. by buying manufacturing capacity in those countries. This can increase productive capacity worldwide and can certainly transfer it from more efficient to less efficient producers.

To take some further examples: a congressman from Texas was complaining recently that one of his constituents, a steel manufacturing company, had successfully sought to increase tariffs on imports of European steel with which it competed. Some time later, however, the company sought the congressman's assistance to *reduce* tariffs on imports of European steel because the Texas company had changed to being a producer of manufactured steel products and wanted its import costs reduced. In another instance, attempts to restrict imports into the United States of Canadian live hogs resulted in an increase in the importation of carcasses. I have also been told that the largest John Deere dealership is now in Saudi Arabia, where the ludicrous support prices paid to producers makes it economic for them to spend large sums on new agricultural equipment.

The point of all of these illustrations is that decisions taken to assist or protect one part of the economy inevitably reverberate throughout the rest, sometimes in unforeseen ways, and can even rebound against those the policies were originally intended to benefit.

The drawback with using bilateral agreements to solve trade and access problems is that such agreements do not address the chief causes of the problem; indeed they can tend to cement them in place. In addition, recent economic history is littered with examples of commodity agreements that have failed, including those where developed countries have attempted to form collusive arrangements intended to raise prices to consumers. One need only look at the various attempts to set up an international wheat agreement between 1933 and 1971, the ineffectiveness of the International Dairy Agreement, and the failure of the various international sugar agreements to prevent the current disastrous situation.

One of the worst consequences of bilateral deals--or at least of deals between developed countries--is that the interests of developing countries are rarely taken into account. Doors can be opened to the developed countries at the same time that they remain shut to the developing countries. The major potential market for growth in agricultural exports from countries such as Australia, the United States, and Canada lies with the developing countries. Even a small increase in effective demand could have considerable benefits. In terms of sheer self-interest, it surely makes more sense for developed countries to be opening their markets to developing countries to enable them to earn the export income to reduce their debt burden and increase their effective demand, rather than closing them tighter through bilateral agreements among themselves.

In Australia's view, one of the major achievements of the Cairns group so far has been its broad perspective. This group, which includes Australia, Canada, and twelve other countries,[1] represents smaller countries for whom trade, especially agricultural trade, is important. It includes developed and developing countries and has succeeded in obtaining a degree of commitment from them on the desirability of reducing subsidization.

When the United States announced its proposal for the MTN in Geneva in July 1987, the Cairns group gave it the warmest welcome. This welcome helps counter an argument that commonly arises from the EC that any genuine change in agricultural trade should only be made between the developed countries. By contrast, it is hard not to be disappointed by the negative tone of the European response so far to the U.S. proposal. The Europeans have tended to dismiss the proposal as impractical and unachievable and have, predictably, suggested such solutions as market sharing and production controls. Even more troubling is their apparent failure so far to accept a basic tenet of the proposal, namely that a major cause of current world agricultural difficulties is the high dependence of production on domestic subsidies.

## A NEED FOR PROMPT ACTION TO CHANGE CURRENT PROGRAMS

The second theme I wish to raise is that there is still a crisis in the world agricultural grain trade. Although the inclusion of agriculture in the MTN and the U.S. proposal to the agricultural negotiating group to phase down and abolish agricultural subsidies are a very promising beginning, unless they are accompanied by early action, the world grain depression will continue.

Implementing the changes suggested in the U.S. proposal will not be an easy task. The changes include reducing aggregate support for agriculture and using producer subsidy equivalents and consumer subsidy equivalents (PSEs and CSEs) as the measures of support (see Blandford's and Huff's papers in this volume for discussions of PSE/CSE).

There are indeed many problems with the PSE/CSE concept, as Dr. Warley noted. These problems prompted our Prime Minister to propose, earlier this year, a simpler benchmark--the so-called price adjustment gap (PAG). This had the benefit not only of simplicity, but also of attacking those subsidies that most affect output, that is, of going to what we see as the very heart of the problem. But whatever the merits of the PAG as a negotiating tool, there are clearly very large political difficulties for governments in completely removing farm subsidies. These are also outlined cogently by Dr. Warley.

Technical barriers can also be important, as Dr. Warley points out. Current proposals in the Congress to increase labelling requirements for imported agricultural products are a good example. He also mentions the U.S. concern with the transparency of the pricing of commodity boards, such as those operating in Australia and Canada. This concern is understandable *if* such arrangements are a means of providing hidden subsidies to growers.

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[1] Argentina, Brazil, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, Philippines, Thailand, Uruguay, Fiji.

In Australia's case this is not so. Moreover, if there were no U.S. farm programs presumably the U.S. private grain trade would not have transparent prices either.

What all this suggests is that even if the U.S. objectives are achieved in the MTN, it will be a slow and laborious process. And yet certainly for grains, the crisis continues. Stocks are growing. In the United States, in spite of a 27.5 percent acreage reduction in the 1987/88 wheat program, U.S. wheat production is predicted by the U.S. Department of Agriculture (USDA) to increase slightly due to higher yields. The USDA also predicts that world stocks of wheat will approach 132 million metric tons (mmt) in 1987/88 and coarse grain stocks will exceed 190 mmt (U.S. Department of Agriculture, 1987). There will be enough wheat in store to bake over 200 billion loaves of bread by the end of 1987.

I do not wish to single out the United States for criticism, especially as the genesis of world wheat overproduction lies with the EC. But I do wonder if current farm policies are acceptable to the American people when:

- Stocks continue to increase, notwithstanding high acreage reduction requirements
- Government income support for farmers is actually increasing at a time when U.S. net cash farm income is at an all-time record high level, recently estimated by the USDA at between $53 billion and $57 billion in 1987 (U.S. Department of Agriculture, 1987)
- Most of these payments go to farmers who by no objective standard are "poor"; some go in huge quantities to very rich people. It is understandable, but a little sad, when so much effort goes into splitting up farm units to qualify for the maximum allowed payment. Hence 100,000 "new" wheat farms and 160,000 "new" corn farms were recorded in 1986 according to reports in the press. In one case, 50 rice farms became 974.

Of course these programs cannot change overnight, but the point I wish to stress is that things in the United States are not getting better; arguably they are not even standing still; they are getting worse. The most feasible change here, which would conform with U.S. MTN objectives, is "decoupling," that is, to divorce income support payments from production incentives. I find it ominous, however, that the U.S. grain groups such as the National Association of Wheat Growers are already coming out in opposition to this approach. Unless farm income supports are separated from production, it is difficult to see how any real progress can be made on grains.

The U.S. experience is surely clear evidence that production controls are relatively ineffective unless they are so severe as to be politically unacceptable. There is just too strong a direct financial incentive provided by current target prices for the farmer to maximize production from those acres that he can use.

There is a fear among farmers that if exposed to market forces, prices will fall even further or, at least, be extremely variable and unpredictable. In the first place it must be stressed that an absence of production controls could enable farmers to increase their income even if the prices are low. Secondly, there are means to counteract price variability without distorting market signals and I discuss these further below.

## THE AUSTRALIAN APPROACH

Australia has in place several programs that, I believe, have been an effective compromise between our government's perceived need to give some help to farmers and the economic desirability of letting market signals flow through.

The first relates to wool. Some ten years or so ago, a revolving fund was created with contributions from producers and the government. The government's contribution has since been repaid by the wool industry. This fund is used by a central body--the Australian Wool Corporation--to buy wool in the marketplace when prices fall below a preannounced level. When prices rise, the wool is sold by the Corporation and the proceeds returned to the fund. For Australian wool growers this fund and the price floor it creates have removed the fear of a bottomless market and made prices more stable and predictable than in a purely open market.

In a sense this program now costs nothing, because contributions to the revolving fund have been repaid to original contributors. Wool prices are currently at record high levels.

The second program, an underwriting scheme for wheat provides a guaranteed minimum price which, in turn, is calculated on a moving average of world market returns for the lowest two of the previous three seasons and the season in question. This has meant that wheat farmers have been given a safety net that has helped to prevent, to use Dr. Warley's phase, "the dysfunctional instability" of the industry, while allowing farmers to adjust production to market signals. Until this year it also had not cost the Australian taxpayer a cent, although at present it appears likely that there will be a payout for the 1986/87 crop.

Finally, we have a rural adjustment scheme, which eases both the amalgamation of farms and the transfer of farmers into other sectors of the economy. This scheme operates essentially through concessional credit arrangements.

We also believe that governments have a responsibility to attempt to educate farmers, to help wean them away from price support programs and not just to accept their demands. This has actually been achieved to a considerable extent in Australia through the combined efforts of governments of all persuasions and by an enlightened Australian rural leadership.

Our farmers have come to accept that macroeconomic factors can affect their net returns just as much, if not more, than the unit price of their product. They have become very concerned about exchange rates and domestic interest rates and the effect of those factors on the budget and trade deficits. They are among the leading groups in the Australian community calling for a reduction in the budget deficit--a stance clearly at odds with a simultaneous call for increases in farm subsidies.

Many also believe that subsidization builds a high cliff from which they will eventually fall because it encourages unnecessarily high unit costs of production. Exposure to world market conditions really does produce the lowest possible unit cost of production. Of course, many in the United States have similar sentiments; included among them are USDA Secretary Lyng and American Farm Bureau President Kleckner.

On the broader trade front, we in Australia see very little progress in the United States towards liberalization. We currently run a 2:1 trade deficit with the United States, and the U.S.'s second largest trade surplus is with Australia. Australia buys about $374 per head per year in U.S. goods ($5.6 billion total in 1986), while U.S. consumers buy only $11 per capita worth of our goods (U.S. Department of Commerce, 1988). Our exports are generally unsubsidized and our own market access is relatively free for agricultural commodities. In spite of Australia's close relationship with the United States, there are constant moves in the Congress to discriminate against us, including current proposals to restrict lamb imports and reallocate our sugar quota.

Bonnen has noted that the U.S. system of government is such that the Congress and administration can, and often do, part company on issues such as trade and agricultural policies. That the U.S. MTN proposals have come from the administration and not the Congress is of importance here. From an Australian perspective, we have to assess the U.S. commitment to trade liberalization not only by the administration's words but by the Congress' deeds.

On one matter both the Congress and the administration seem to be in agreement: export subsidies. The Export Enhancement Program (EEP) looks likely to continue vigorously over the next few years. The administration argues that this brings the EC to the negotiating table. Even if it does, it hurts nonsubsidizers like Australia by keeping prices down. And has it really helped U.S. exports? To be sure, wheat exports are projected by the USDA to increase from 25.5 mmt in FY 1986 to 30 mmt in FY 1987. But the *value* of those exports is projected to decline from $3.26 billion to about $3.1 billion (U.S. Department of Agriculture, 1987).

There is little doubt that it is politically impossible for nations to take remedial actions individually. Everyone must be seen to be acting together. It is very important, therefore, in bilateral arrangements between the United States and Canada that any agreement on agriculture move domestic programs in the direction of the MTN objective. This includes not only production support programs, but also access issues. For example, Australia would be understandably concerned if Canada were given exemption from the provisions of the U.S. Meat Import Law and if, as a result, the overall trigger was reduced by the amount of current Canadian imports. A similar comment could be made with an exemption for Canadian sugar in U.S. import provisions. Any combination of U.S. and Canadian grain programs would clearly have an effect on other producers.

In conclusion, it will be obvious from these comments that I consider that any real reform in agricultural trade can only be made multilaterally. Although the U.S. objectives as outlined in the proposal to the agriculture policy group for the MTN are laudable, achieving them will be a slow process. And finally, short-term agreements, whether bilateral or single commodity, can help to achieve long-term objectives only if the agreements themselves are compatible with the long-term objectives.

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# SUMMING UP: THE U.S. PERSPECTIVE

## D. Gale Johnson

As this conference has progressed, it became rather obvious to me that there was a not-so-hidden agenda that was much more relevant, or much more in people's minds, than the stated objective of considering the possibilities of gains and losses from a North American free trade area for foreign products.

The hidden agenda has very little to do with whether there is free trade in agricultural products between Canada and the United States. One part, perhaps the major part of the hidden agenda, is concern about what would happen if there were free trade in all agricultural products within either Canada or the United States. Just imagine how disruptive it would be if milk could move freely from one province to another in Canada or from one milk market to another in the United States, particularly if you allowed reconstituted milk to be sold as fluid milk. Thus there are areas within each of our countries where we don't have free trade with respect to some products.

But more fundamentally, the hidden agenda is the opposition to reform, reform of agricultural programs and policies in Canada and the United States. Again, this opposition has little or nothing to do with the creation of a North American free trade area, but with the pressure that exists for reform in both our countries, due in the case of the United States to the high governmental costs or in Canada to a mixture of some governmental costs and relatively high prices for certain farm products.

True, the creation of a free trade zone would make the need for reform more evident on both sides of the border, if nothing more than to achieve some degree of harmonization of several very disparate farm programs. But even a casual observer of economic and social policies knows how difficult it is to reform policy, even when there is broad agreement that the policies have failed to achieve the stated objectives and it is also accepted that several superior alternatives are available. It makes no difference what political system is involved, whether it is a western democracy or a dictatorship. In spite of all the recognized defects in the effectiveness of agriculture policy in the European Economic Community (EC) and the United States, there has been no significant reforms of these programs during the past decade.

In the past decade there have been very few successful reforms of agricultural policies anywhere in the world. In fact, only two come to mind, and I doubt if the actual number can be twice that. The two successful reforms are to be found in New Zealand and China, countries with rather different political and economic systems. But the reforms had two things in common--they were radical reforms and they were carried out in a relatively short period of time. One thing that bothers me about the U.S. administration's proposal for the GATT negotiations is that we are to keep cutting the tail off an inch at a time for ten years and it might be easier if we took it all at once.

Why is reform so difficult to achieve and so elusive? Some attempts at reform, such as in the United States with the 1985 farm legislation, may well have made future reforms more difficult than they were prior to that legislation. But without going into any systematic analytical presentation of why reform was so difficult, though James Bonnen gave us the rudiments of such an analysis in an earlier paper, I believe a major barrier to reform is clearly evident, and it is one that has been displayed at this conference repeatedly.

I make my point by reference to the analysis of the efforts to reform the Soviet system since Stalin's death, and these efforts have been largely unsuccessful. There have been many attempted. Perhaps the best informed and wisest observer in the United States of Soviet economic policies is a good friend of mine, Gertrude Schroeder. She has followed the reform efforts in the Soviet Union at least since the Kosygin reforms attempted in the mid-1960s, reform efforts that have been ineffective and in many cases may have worsened rather than improved the performance in the Soviet economy. Why have the reforms failed? She argues that regardless of how badly the Soviet economy is performing, relative to its potential, there are literally millions who have found ways to profit from the system, have found a profitable niche in the system, and have found ways to make the system work for them. These millions would lose their positions of privilege if there were successful reforms that significantly reduced the power of the bureaucracy to control and manipulate. Thus, the bureaucracy has frustrated what many of us believe have been men of great power and authority: Khrushchev, Kosygin, Brezhnev, Andropov, and now Gorbachev. It is not yet clear that Gorbachev will prove an exception, but I don't think the odds are very great that he will.

It seems fairly obvious that much of the concern about farm policy reform is that the current agricultural programs in Canada and the United States have created substantial rents, sources of continuing income for those who own assets that produce a return solely because of their scarcity value that was created by a government program. I refer to those who, for example, own the right to produce tobacco, peanuts, or sugar in the United States or own productive corn or wheat land in the United States, or the quotas that are necessary to produce chickens, eggs, turkeys, and milk in Canada.

Reforms, whether they are associated with the free trade or not, threaten the continued existence of these valued assets which these individuals have either received as a gift from their government or have had to purchase in order to produce legally these particular products. The gifts are distributed when the programs of supply management or subsidies first start--when the rights to produce are assigned. After a time, those who use the rights differ substantially from those who own them. For one major kind of tobacco in the United States, for example, two-thirds of the rights to produce the tobacco are owned by people who do not produce any tobacco, but they continue to receive the income from the quotas, and not just a little bit but an awful lot. Recently the annual rent on a quota, rent from one year, to produce a pound of tobacco was from a third to two-fifths of the price of the tobacco, and it is not obvious why the tobacco program is called a program for farmers. It should be called a program for widows, retired farmers, doctors, dentists, and probably a few politicians.

But enough on why reform is so difficult. More emphasis needs to be given to the content of reform that might be called for by a North American free trade area or by the multilateral negotiations (MTN) if there is to be significant trade liberalization and if North American farmers are to be given the opportunity to compete for world markets on the basis of their comparative advantage and as low-cost, efficient producers of many, although not all, agricultural products.

If North America is to argue for policy changes in the EC, European Free Trade Area (EFTA), and Japan that improve the access for our crop products--grains and oilseeds--we can't say to EC farmers, "You have no right to compete for the North American milk and milk products markets," for example. Dairy producers from North America start from a defeatist position: it is assumed that they can't compete with the EC producers, let alone New Zealand and Australia. Perhaps such is the case, because our farm programs have so sheltered dairy producers that we don't really know if there could be a large and efficient dairy industry in North America. There is no reason that I can see why EC dairy producers should be lower cost than North American producers for the basic product of milk. Dairy processing such as cheese may be lower cost in the EC than in North America, but if our cheese producers were forced to compete for the North American cheese market, rather than having been given it on a platter, they might produce a larger variety of desirable cheeses than is now found to be necessary due to the restricted access to our cheese markets. But for other dairy products I see no reason why processing is not as low cost and efficient in North America as it is in the EC.

The North American free trade agreement could be used to discuss how agricultural programs in Canada and the United States could be made more market-oriented and harmonized over time in preparation for a successful MTN. I'm not here disagreeing with the point that Dale Hathaway made; I'm not saying that we should as a part of the bilateral agreement reach final consensus on these issues, but I think that if North American farmers are to be adequately represented in the MTN we really need to have a set of views within the two countries as to where we are going and how we are going to get there, recognizing that it will be a long time before we get there and we don't have to table it until we're in the MTN. But we can't just go to the MTN naked of any ideas of what we are going to do.

I put the outcome of the MTN in the affirmative way, because it's obvious that unless the United States and Canada are willing and able to reduce their interventions in trade that subsidize output and/or exports or by limiting imports by quantitative restrictions, then there is no likelihood of success in the MTN negotiations. In other words, if North America can't get its act together, I think we should save on all that rent on high-priced apartments in Geneva for our negotiators. We're not going to get much return for our investment. You know, that's one thing about GATT negotiations I think we all should recognize, they hold them in damned nice places, and that's to make things comfortable for the negotiators. We should hold the negotiation in some place such as a small city in interior Brazil or some similar place, and then they'd worry about getting their job done.

If discussions about making North American farm programs more market oriented, more responsive to underlying market conditions that reflect world market supply and demand are occurring, then they are a very well kept secret. Certainly there was little in our discussion here, papers or comments, to indicate that such discussions are occurring or that there is great interest in having such discussions. I fear that failure to broach these matters may well have significant negative consequences to both the bilateral and multilateral negotiations.

Dispute settlement has been given a great deal of attention in this conference, and I can well understand why our Canadian members are upset and angered by U.S. actions in countervailing duty actions. I've looked at two cases, for example, with some care--the live hogs and the softwood lumber cases. The economic reasoning and analysis in both cases struck me as worth no more than a D minus in a paper in an intermediate microeconomics course. In fact, that might be an act of generosity.

My reading of the softwood lumber case is that the increase in the share of Canadian lumber in the American market over the period of time being protested is very small indeed--I think something like 3 percent. Most of this increase was due to factors other than the ones that were claimed to have been important. For example, I think it was due in part to exchange-rate changes, which certainly were not manipulated in favor of Canada to help out the softwood lumber people. Wage-rate changes between the two countries again were just marginally positive toward the Canadian side, but not generated for the purpose of increasing exports of lumber. The relatively long-term manner in which U.S. stumpage fees are set by bidding compared to more flexible Canadian procedures of adjusting fees to the state of the market was also a factor in the market shifts, plus the effect, interestingly enough, of the Jones Act governing shipping, which made it cheaper to ship British Columbia lumber to the southeast United States than to ship lumber from Washington or Oregon. If lumber is shipped from Washington or Oregon to the U.S. Southeast it has to go in American bottoms, whereas it can be imported from Canada at the lowest possible rate. All of the increases in Canadian shipments were to the Southeast. Probably if the U.S. west coast lumber products could have shipped in international bottoms, this might well not have happened. So there were so many different factors of which the stumpage fees were only a minor part.

The other one is the live hog case, and here I'm just stating the puzzle. How it can be that Canadian live hogs are subsidized (I'm not saying they are) and pork products are not subsidized is a great mystery to me. If not, then the Canadian pork producers should organize an anti-monopoly investigation against the meat processing industry in Canada. There's no way if there is any degree of competition in processing that if you subsidize the price of a hog, you haven't subsidized the price of pork.

As far as Canada and the United States are concerned, if there is significant harmonization of farm policies, the potential for disputes will be greatly reduced. This very important point was made this morning. If programs are quite transparent and similar, there would not be much of an argument about it on a bilateral basis, but assuming that there will be a long transition process, probably as long as a decade for the harmonization, there will clearly be a need for some form of dispute settlement that is truly joint during this period of time at least.

# SUMMING UP: THE CANADIAN PERSPECTIVE

## Andrew Schmitz

I'm delighted to be here. This conference isn't quite as controversial as the one held in Brussels in July 1986 on the confrontation between the European Community and the United States concerning agricultural policy. However, it has raised similar issues.

I've had the honor and pleasure to work in both countries as an academic. Also, I'm a bankrupt wheat farmer from Saskatchewan, so I thought I would tell you a joke, because there are also bankers in this group. The other day a banker sat down with a farmer and they went through several accounts and they showed the farmer losing money on the wheat account but the farmer never said anything. They went through the beef account and the farmer was also losing money and the banker said, "My God, you're in deep trouble." The farmer never said anything, so they continued by examining the poultry account, which also showed a loss. The banker said, "I don't understand the issue here, aren't you even concerned?" "Oh, no," the farmer said, "It could have been worse; it could have been my money." The not-so-funny truth is that this could have taken place in either the United States or Canada any time over the past few years. The degree of stress is similar on both sides of the border.

Canada-U.S. trade is important; there are gains to be had from freer trade between United States and Canada, but what's more important is the perspective that the Canada-United States free trade talks give on the resolution of the international trade war in markets outside of the United States and Canada. Let me emphasize this point. Some of the studies that have been done suggest that freer trade in agriculture between the United States and Canada could result in a gain of at least Can$200 million and possibly approaching Can$500 million. The interesting point is that when the United States dropped the wheat loan rate by a dollar, under the 1985 Food Security Act, the cost to the Canadian farmers was at least a billion dollars. In other words, the United States' dropping the loan rate by a dollar had a negative impact on the Canadian economy greater in magnitude than any positive effect resulting from liberalized agricultural trade between the United States and Canada. There's no way one can generate a $1 billion gain from freer trade in agricultural products between the United States and Canada, at least from the estimates I have made. When you take this perspective, the international grain war dominates the discussion of Canada-U.S. freer agricultural trade.

Prairie agriculture in Canada cannot survive without international trade, because it has a small population relative to its massive natural resource base. Without trade the alternative will be to take most of the land and put it into buffalo production coupled with casinos to attract American tourists.

To make things worse for the region, the prairies also have oil, uranium, and potash. The prices of these commodities move up and down together, so the peaks and valleys in economic activity are accentuated. Trade takes on even greater significance when our definition of agricultural products is broadened.

As some of the people in this room know, I have never been a supporter of the 1985 U.S. farm bill, but there is no mystery as to why it was passed nor why it is unlikely to change. The U.S. farmers cannot do any better under free trade (and they're likely to do worse) than they could under this bill. Under free trade, there isn't any way that wheat prices, at least in the short term, will rise above target prices. The theory of rent seeking explains why a lot of groups support the bill. If producers can do better with government programs than under a free market, why would they be interested in free trade arrangements? Why would producer groups form coalitions to support freer trading arrangements? You think about that. For wheat growers to support free trade and a free market agriculture at the present time, there would have to be net gains involved; yet they know that, if they get higher prices from the marketplace, deficiency payments are going to drop.

In the United States at the present time there seems to be no clear policy on international trade. In international trade theory there is a concept called "gains from trade," and I've heard it used several times in this conference. However, the concept, unfortunately, does not seem to enter policy discussion. In policymaking we see the worst of all criteria--market share. The main aim of the United States at the moment is to get back its market share in the world wheat trade at all costs. However, there are little or no gains to be had from trade in agricultural products in the context of subsidy wars, even though to gain market share trade volumes must increase. Models of markets with tariffs and nontariff barriers and subsidies generate results that show that the trade costs from barriers and subsidies can offset the domestic benefits they confer. This is the position the United States is in! We talk about gains from trade in theory but in reality we don't use this framework to analyze whether trade is good or bad in terms of gains from agricultural trade. We look at trade strictly in a trade war context, using market share as the policy criterion, and I think that is the wrong approach.

Under the 1985 Food Security Act, the U.S. is subsidizing food sales to the Japanese and the Russians. Why they want to do this is a mystery to me. Why give these rich countries wheat at $2 a bushel when we know variable production costs are at least $3.50/bushel? No wonder Japan is a rich nation! For Japan, when the United States dropped the wheat loan rate a dollar in the 1985 bill, all that happened was that the Japanese treasury essentially saved another dollar per bushel of wheat imports. Colleagues and I recently did a little study for a meeting in Michigan on Canada-Japanese trade, and we figured that the Japanese picked up at least $250 million from the United States' lower loan rates. This is because in Japan internal prices are fixed and hence import volumes do not respond to world price declines!

Although tariffs are used extensively in international trade, the United States often uses quotas instead. We know that the use of quotas is consistent with the monopoly cartel argument. The way to raise prices by forming a cartel is to have the United States agree on voluntary quotas. Quantity is restricted, prices go up, but the quota rents go to the exporter, not to the United States government. So, if one is going to use a trade instrument, tariffs are much better, because the government, by putting on the tariff, is at least collecting the tariff revenue. With a few exceptions, Canada's future in prairie agriculture is not fully dependent on the U.S. market. In terms of the major grains the only hope for Canada is the international marketplace; Canada has a great comparative advantage in the world grain trade, but under the present world trading conditions it's actually going to go out of business unless the treasury can keep pouring in more and more money to farmers in line with the U.S. farmers' benefits from the 1985 farm bill.

I thought it was a good idea to bring people from both countries together at this conference to learn about different institutions about which there is much misunderstanding. One example is the Canadian Wheat Board. I don't know why the Wheat Board remains a mysterious agency to some Americans. Take pricing, for example: the Board does not disclose selling price information. But the point is, and I see Rob Johnson sitting here from Cargill, that Cargill and other similar firms do not tell you folks how much money they make from wheat and their selling prices in the international marketplace either. It's a trade secret for the Wheat Board just as it is in any private company, so why do we have the perception that the Board distorts trade and the private sector does not?

In western Canadian agriculture, the livestock trade, in my opinion, has a strong future and part of it lies in the Pacific rim area. The feeling, at least in the United States, is that the U.S. cattle feeding industry is going to move, over time, further and further toward the Southeast, which means that western Canada is going to increase its comparative advantage in feeding cattle. One of the big markets is obviously California. California, even with its large population, is losing both the pork and beef trade. Certainly, freer trade will help in that there will be a more secure market for Canada. Canadians can't sit back and use excuses for not aggressively marketing pork and beef abroad; at the moment tariffs on beef and pork are low. How to penetrate a market such as California is still an unsolved issue for most Canadians.

I think both Canada and the United States have a lot to learn about how governments can help the private sector and vice versa in terms of export market development and penetration, and it has little to do with freer trade between the two countries. That has more to do with marketing skills and how an industry can move into the marketplace.

The final point I'd like to raise concerns countervailing duty cases. At least Gale Johnson can't give me the D he referred to because while I sat in on the pork case I didn't do any of the analysis for it. But I did do some analysis for the Ontario corn countervail case against the United States. In my opinion, these disputes have to end. The point was made earlier that since the government created this problem with subsidies the government should also resolve these disputes. This is a good point. Why do we have to go to the private litigation system in order to resolve these issues? The other point concerning countervailing duty actions is that they have broader implications. The point is that it wasn't just a hog countervail case, nor just the corn case per se; these have much broader implications. Let me give an example. I sit on the Board of Directors of the Potash Corporation of Saskatchewan; shortly after the corn case, the Americans brought a countervailing duty action on Canadian potash going into the U.S. market. Potash is a big industry in Canada and its biggest market happens to be the United States, so it would seem natural for U.S. corn farmers to support the Potash Corporation of Saskatchewan in an international trade dispute because obviously farmers and dealers in the United States want to have low potash prices. So some of us did contact the corn growers and the corn growers said that's fine, but there's one problem. Do you remember the Ontario corn case against us? You see, when you talk about trade and you think narrowly, it always comes back to haunt policymakers. One can't stop water in the stream at one spot because the water is going to bypass that spot and keep running down the stream anyway. There are no net gains from this futile attempt.

In trade disputes (e.g., pork and corn) it doesn't much matter which groups lost and won; the point is that the magnitudes of the gains and losses were insignificant compared to the gains to be had from trade and moving toward freer trade and less distorting domestic policies. As illustrated, trade in Ontario's corn industry can have implications even for an industry that is as far away from Ontario as the Saskatchawan potash industry. Trade in corn and potash are interrelated. In this regard, rent seeking by producer groups at the micro level is often inconsistent with macro gains from trade. This problem is just one among many to be faced by policymakers and politicians in moving to freer trade.

# EPILOGUE

## Kenneth R. Farrell

> The boundary between Canada and the United States is a typically human creation; it is physically invisible, geographically illogical, militarily indefensible, and emotionally inescapable.
>
> --Hugh L. Keenleyside (1929)

The legislatures of Canada and the United States are, or soon will be, in the throes of debate on ratification of the trade accord signed on January 2, 1988. As important as the Canada-U.S. Free Trade Agreement may be, it cannot be viewed in isolation. Both countries are also preparing for another round of multilateral trade negotiations (MTN) under auspices of the General Agreement on Tariffs and Trade (GATT)--the so-called Uruguay Round. This year the U.S. Congress will once again take up debate on omnibus trade legislation in a setting of rising protectionist sentiments. And the agricultural sector in each country is still recovering from a series of international trade-related dislocations that occurred in the first half of the 1980s.

I know that emotions run high in Canada concerning the Canada-U.S. Free Trade Agreement. I am reminded of a remark, attributed to a U.S. journalist, to the effect that Canadians are generally indistinguishable from Americans and that the surest way of telling the two apart is to make this observation to a Canadian. I know it is almost impossible to engage in discussion of the agreement without delving into the political, social, and cultural aspects--and the differences between the two countries in these areas--as well as the economics. For this paper, however, I will confine my remarks principally to the economic aspects of the agreement as they relate to agriculture, leaving aside those other, equally important, issues.

### AGRICULTURE AND THE CANADA-U.S. FREE TRADE AGREEMENT

The 250-page Canada-U.S. Free Trade Agreement, signed after almost twenty months of negotiations, calls for the phased elimination of barriers to trade in all goods and services over a ten-year period beginning January 1, 1989. Major provisions involve automotive parts, energy, investment, and services, including financial services. Unlike a treaty that requires only U.S. Senate approval, ratification of this agreement in the United States will require legislation that must be approved by both the House and the Senate. After the president submits the agreement, the Congress will have ninety working days in which to act by accepting the agreement without amendment or by rejecting it in its totality. U.S. Trade Representative Clayton Yeutter has indicated that the Reagan administration will not submit the agreement to Congress unless the agreement receives support from all ten Canadian provinces. With many recesses expected in the Congress during this presidential and congressional election year, congressional consideration of the agreement could be slowed until after the November elections despite the so-called "fast track" authority.

As in most trade negotiations, agriculture received special, sectoral attention in the Canada-U.S. negotiations. The specific terms of the agreement related to agriculture concentrate on removal of remaining tariffs and relaxation of nontariff barriers. By and large, the agreement does not alter underlying agricultural policies in either country, choosing instead to leave such issues to be addressed in the multilateral context. On the assumption that most readers have already examined the agricultural provisions in detail, I will only briefly summarize them here:

- All tariffs would be eliminated within ten years, with a proviso that "snapback" tariff rates would be allowed for twenty years for fruits and vegetables.
- Canadian products with 10 percent or less sweetener would be exempted from U.S. quantitative restrictions.
- Canadian import licenses would be eliminated for U.S. wheat, barley, oats, and their products, provided that U.S. subsidies for these products were equal to or less than the respective Canadian subsidies.
- Neither country would impose or reimpose quantitative restrictions on grain as long as there are no significant changes in grain support programs that lead to an increase in imports from the other country.
- Canadian transportation subsidies under the Western Grains Transportation Act would be eliminated for products moving through western ports to U.S. markets.
- Canadian global import quotas for poultry, poultry products, and eggs would be increased to equal the annual average of actual shipments in the past five years.
- Each country would exempt the other from its meat import laws.
- U.S. wine and distilled spirits would receive "more equal" treatment in Canadian markets--in pricing, distribution, and retailing practices.
- The two countries would not use direct export subsidies on agricultural products shipped to each other.
- Each country would agree to consider the export interests of the other in any use of export subsidies to third countries.
- The parties would work toward minimizing technical barriers (health, labeling, etc.) on agricultural, food, and beverage products.
- Canada and the United States would consult semiannually and at other times as mutually agreed on agricultural issues.

Beyond these specific provisions, two general provisions of the agreement could have important implications for agriculture. They are as follows:

- ***Dispute settlements***. Both countries would retain national laws regarding antidumping and subsidized imports. Disputes regarding application of each country's trade remedy laws could be appealed to a bilateral panel that would provide a nonbinding dispute-settlement mechanism.

- ***Import safeguards***. Temporary import relief would continue to be available to industries injured by import competition. During a three-year transition, lower duties resulting from the agreement could be suspended if imports from the other are found to cause injury to the domestic market.

It is difficult to assess the net economic effects of the agreement on either Canadian or U.S. agriculture. Because tariffs are already relatively low, their phased elimination is unlikely to produce any dramatic effects on either side of the border. It is not clear what modifications of technical standards are to be made, but they are likely to occur incrementally over a long period. The dispute settlement process may help to moderate the contentiousness that has marked some aspects of agricultural trade relations in recent years, but it does not alleviate in any major way the source of that contentiousness--domestic agricultural policies and protectionist laws that undergird them. In summing up the symposium, Andrew Schmitz (in this volume) mentioned that very crude estimates of net gains from completely free trade in agricultural products between the two countries range from $200 million to $500 million. Clearly the direct gains from the accord that has been signed would be of lesser magnitude.

Although the aggregate direct economic effects of the agreement would appear to be marginal, regional and commodity effects will vary. Superficially, at least, it seems that higher-valued, processed products, by virtue of higher prevailing tariffs, would be affected more than raw products. However, these products are subject to many nontariff trade restraints--regulations on labeling, packaging, processing procedures, ingredients, and use. On balance, producers and consumers of fruits and vegetables on each side of the border may gain marginally, with somewhat larger gains to U.S. producers overall, but with some gains to Canadian producers closest to the larger U.S. population centers in the Northeast and California. Beef, poultry, and egg producers on each side of the border might benefit marginally from expanded cross-border regional trade. Generally, the agreement will tend to increase north-south trade and decrease east-west trade, particularly in Canada.

Not to be overlooked are potential longer-term and indirect effects of the agreement. To the extent that other provisions of the agreement affect employment and incomes in either country, demand for food could be affected. To the extent that the agreement enhances in-country competition, consumers may benefit. To the extent that the agreement enhances access of Canadian industries to large U.S. markets and to the extent that scale effects exist, Canada might benefit marginally in two ways: from more efficient, lower-cost production and from larger markets.

With respect to agriculture, the agreement represents a marginal continuation of a long-term trend toward liberalized trade. Of equal or greater significance than tariff reduction and quota relief is the reaffirmation of mutual interests in trade liberalization, recognition that policy adjustments should be coordinated between the two countries, and recognition of the need for mechanisms to resolve trade disputes in an orderly way. But equally true is the fact that the policies that govern agriculture in the two countries remain fundamentally different in approach and design, each with a formidable battery of protectionist devices still in place.

Although the agricultural provisions of the Canada-U.S. trade agreement might provide marginal net economic gains on both sides of the border, the economic significance of the pact is largely in sectors other than agriculture. The major issues that relate to the agricultural trade of each country are those that must be addressed in a multilateral context.

The Canada-U.S. agreement is a prelude to the MTN. It will be ratified or rejected not on the basis of larger gains or losses in either country in agriculture, but upon potential economic effects in other sectors and upon judgments of much broader political, social, and cultural implications with respect to national sovereignty.

## TYING IN TO THE MULTILATERAL TRADE NEGOTIATIONS

Relative to the Uruguay Round of the MTN, the Canada-U.S. negotiations might be viewed as an intra-squad game. In the course of this early game, both the United States and Canada have signaled preparedness to play, sharpened the game plan, and honed the skills of some potential players. With the MTN, however, we do not yet know fully what the rules of the game will be. We do know that the opposing teams will be strong and their game strategies fundamentally different in several respects. If past games are any indication, the Uruguay game will likely be low scoring, with an occasional long ball but few home runs. We know further that the outcome is of far greater potential economic significance to agriculture than our just-concluded intra-squad game.

The MTN will provide little net benefit to either Canadian or U.S. agriculture unless the negotiations deal substantively with an underlying cause of trade distortions--internationally dysfunctional public policies for agriculture--something the Canada-U.S. agreement did not do. To pursue negotiation strategies similar to those of recent GATT rounds would be akin to rearranging the deck chairs on the Titanic.

Even enlightened multilateral negotiations on agriculture will not be sufficient to set world agriculture on a sustainable course of growth. That will require, among other things, internationally coordinated macroeconomic policies, resolution of the huge foreign indebtedness of the developing countries, and long-term capital investments (domestic and international) to stimulate and sustain economic growth in those countries. The future economic development of both Canadian and U.S. agriculture is inextricably dependent on growth in international trade. It is, therefore, in our mutual long-term interest to pursue policies to enhance global economic development and policies and institutions to facilitate world trade in agricultural products.

## THE IMPERATIVES OF TRADE

When viewed in broad historical perspective, agricultural development in the United States and Canada has accorded reasonably well with the principle of comparative advantage.[1] By virtue of geography, climate, resource endowments, and markets, the United States and Canada together have a comparative advantage in some commodities vis-à-vis the remainder of the world (e.g., grains, oilseeds, and livestock), and they have emphasized the production and export of those commodities while importing those products for which they are comparatively disadvantaged (e.g., some fruits, vegetables, and beverages). On balance, each country has espoused policies of liberal trade in agricultural products over much of the past century.

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[1] Reduced to its most elementary form, the principle asserts that nations will maximize their economic welfare by using their limited resources to produce those goods and services for which each has an economic advantage compared to other nations and importing those goods and services that they produce relatively less efficiently. The real world, of course, is far different from the frictionless, apolitical world assumed in the classical economic theory.

Neither Canadian nor American farmers need to be convinced of the economic importance to them of international trade. Exports are the economic lifeblood of the Prairie provinces and the Great Plains and Corn Belt states. For both Canadian and U.S. agriculture, the economic stakes in maintaining or expanding exports of grain and oilseeds to the rest of the world dwarf the gains to be obtained from marginal liberalization of U.S.-Canadian agricultural trade. It also is apparent why agricultural interests in each country should react negatively to policies of the European Economic Community that erode markets in third countries and why Canadian agricultural interests should object strenuously to export subsidies and other provisions of the U.S. Food Security Act of 1985 designed to enhance U.S. agricultural exports. For much of the past six years, world grain trade has been a "zero sum" game, and gains for the United States were often at Canadian expense, and vice versa.

Producers, consumers, and taxpayers in many parts of the world stand to gain from coordinated, multilateral reform of domestic agricultural policies and an accompanying liberalization of trade policies. In particular, I believe that the United States and Canada stand to gain from such reform and liberalization. Indeed, I believe reform and liberalization are imperative if agriculture in the two countries is to experience economic growth into the twenty-first century. That is so for at least two major, interrelated reasons, as discussed below.

## Continued Productivity Growth

Total factor productivity of U.S. agriculture grew at an annual rate of 1.57 percent during the period between 1950 and 1982 (Capalbo and Vo, 1986). The productivity growth rate in Canada has been close to that in the United States--1.6 percent annually between 1961 and 1980 (Tung and Strain, 1987). Much of that growth is attributable to the development and application of science-based technology, to associated scale effects, and to improved management of resources, despite concerns about the environmental effects of some of these technologies. I see no inherent reasons why long-term productivity growth rates in U.S. and Canadian agriculture will not be sustained over the next thirty years. A new array of biological technologies is just beginning to come on stream. Some have the potential of yielding dramatic increases in productivity.

This potential growth in agricultural productivity and output will also be enjoyed by other developed countries and by many of the developing nations that have upgraded their agricultural research capabilities over the past several decades. It is not only the marketing and trade of agricultural commodities that have become internationalized and globally interdependent--so have science and technology.

## Maturing of Food Demand in the Developed Countries

As countries develop economically, food demand and consumption change dramatically. Canada and the United States are now considered to have mature economies. In both countries, income elasticity of demand for food is low, approaching zero in the aggregate. Population growth rates have slowed. By the year 2000, some projections suggest that the population growth rate in the United States will have dropped to less than 1.0 percent annually. These characteristics have very important implications for agriculture and the food industries in both Canada and the United States.

Projections by the U.S. Department of Agriculture point to about 17.5 percent growth in per capita food consumption and a 39 percent growth in total food consumption in the United States between 1980 and 2000, assuming a 2.0 percent annual growth in per capita income (Blaylock and Smallwood, 1986). But the per capita consumption growth rates vary widely among commodities: 21 percent in fish, 15 percent in vegetables and cheese, 13 percent in fruit, and 12 percent in beef. For food grains such as wheat and rice, the growth will be much less.

Coupling productivity and demand growth projections, the importance of access to foreign markets to equilibrate production potential with food demand can be readily appreciated. For commodities with potentially high productivity growth rates and low domestic demand growth rates (food grains, feed grains, oilseeds, dairy products, and perhaps beef), maintenance or expansion of export markets is central to their economic future. The alternatives are to withdraw resources from production and gear down the agricultural production plant, to continue to insulate agriculture from the dynamics of the international market with import restrictions and export subsidies as in the past, or to move toward global liberalization of domestic agricultural and trade policies to provide greater opportunities for commodities in which the United States and Canada have a comparative advantage.

For these reasons, I believe Canada and the United States should jointly provide leadership to reform agricultural policies and liberalize trade policies in the forthcoming MTN. Although the Canada-U.S. trade agreement is largely mute with respect to agricultural policy reform, it is symbolically an important signal to the rest of the developed world of our interests and intent in liberalization of trade. We should capitalize on the momentum of the accord.

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# SYMPOSIUM AGENDA

## WEDNESDAY, JULY 22

Dinner
**Welcome and Introduction**
    George E. Rossmiller, *Director, NCFAP*

## THURSDAY, JULY 23

**Opening Remarks**
    Maureen Farrow, *President, CDH*

**"An Off-the-Record Briefing by Agricultural Trade Negotiators"**
    Michael Gifford, *Canada*
    Leo Mayer, *United States*

***Session Chair:*** Brian Oleson, *Canadian Agricultural Economics and Farm Management Society*

**"Institutions, Instruments, and Driving Forces Behind National Agricultural Policies"**
    James T. Bonnen, *Michigan State University*
    H. Garth Coffin, *McDonald College, McGill University*
Discussion

**"Agricultural Trade Between the U.S. and Canada: Key Issues"**
    Bob H. Robinson, *U.S. Department of Agriculture*
    Barry Mehr, *Alberta Department of Agriculture*
Discussion

***Session Chair:*** George E. Rossmiller

**"Measuring the Trade Effects of Domestic Agricultural Policies and Identifying the Gainers and Losers in a U.S.-Canadian Free Trade Agreement"**
    David Blandford, *Cornell University*
    Bruce Huff, *Agriculture Canada*

**Concurrent Commodity Panel Sessions**

1. Animals and Products
   *Chair*: Fred H. Sanderson, *NCFAP*
   Paul Christ, *Land O'Lakes*
   Arne Mykle, *Canadian chicken producer*
   Richard Pasco, *National Pork Producers Council*
   Dave Adams, *Canadian Meat Council*

2. Plants and Products
   *Chair*: Maureen Farrow, *CDH*
   Ted Turner, *Prairie Pools*
   James Clawson, *The Clawson Company*
   Dan Dempster, *Canadian Horticultural Council*
   Howard Collins, *Brewers Association of Canada*

**Reconvene** for general discussion and reports from concurrent session chairs and rapporteurs

Dinner
**Introduction**
Maureen Farrow

**"North American Agriculture in an Interdependent World: Challenges and Opportunities"**
Hon. Charles Mayer, *Minister of State (Canadian Wheat Board)*

**FRIDAY, JULY 24**

***Session Chair***: Maureen Farrow

**"Formal and Informal Non-Tariff Barriers to Agricultural Trade Between the U.S. and Canada"**
Elmer Menzie, *University of Guelph* and
Barry Prentice, *University of Manitoba*
Discussion

**"Resolving Subsidy, Countervail, and Import Disruption Issues in U.S.-Canada Agricultural Trade"**
Bill Miner, *Institute for Research on Public Policy*
Robert Hudec, *University of Minnesota*
Tom Saylor, *Consultant*
Debra Steger, *Fraser and Beatty*
Discussion

**"Linkages Between the Bilateral and Multilateral Negotiations in Agriculture"**

T. K. (Sandy) Warley, *University of Guelph*

**Discussants**

Dale Hathaway, *Consultants International Group, Ltd.*

Timothy Mackey, *Australian Embassy*

Discussion

**Concluding Session**

*Chair:* Kenneth R. Farrell, *University of California System*

D. Gale Johnson, *University of Chicago*

Andrew Schmitz, *Economic Council of Canada*

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July 22-24, 1987

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